

V. Costs

A. Summary of Results and Comparisons

During the 1998-2002 audit period, the utilities spent \$1.1 billion on energy efficiency programs, approximately \$261 million less than the authorized revenue requirement, as shown below.

Exhibit V-1: From 1998 through 2002, the Utilities Spent \$261 Million less on Energy Efficiency Programs than the Authorized Revenue Requirement [Note 1]
(Dollars in Thousands)

| Utility | Revenue Requirement | Expenditures | Difference |
|--------------|---------------------|--------------------|------------------|
| PG&E | \$594,340 | \$465,548 | \$128,792 |
| SCE | 409,287 | 325,934 | 83,353 |
| SDG&E | 222,901 | 172,225 | 50,676 |
| SCG | 135,857 | 137,966 | (2,109) |
| Total | \$1,362,385 | \$1,101,673 | \$260,712 |

Note 1: Does not include commitments.

With minor exceptions, PG&E's direct costs relating to energy efficiency program delivery including labor, non-labor and incentives are properly supported and classified as energy efficiency costs in accordance with applicable accounting principles and regulatory requirements. The audit indicates almost all Provider Cost Center (PCC)-driven costs in the energy efficiency programs are appropriate; however, there are some charges from PCCs with no direct involvement in energy efficiency activities. Supervisory and interdepartmental charges to energy efficiency programs include \$255,000 for payroll taxes and benefits, which are also included in base rates.

In general, SCE's direct energy efficiency costs are properly supported and classified. Minor exceptions and control deviations were noted; however, no material adjustments were identified. blueCONSULTING's testing identified violations of SCE's procurement card policies; timing issues related to advance payments for advertising; and incorrect charges to SCE's energy centers (Customer Technology Application Center (CTAC) and Agricultural Technology Center (AgTAC)) which arise from the dual-purpose nature of these programs. CTAC and AgTAC are partially funded by PGC funds and partially by Operations and Maintenance (O&M) funds. Controls over charges to CTAC and AgTAC should be improved.

SCE charged only three categories of allocated overhead costs to the energy efficiency programs during the audit period: charges from other departments; lease costs associated with one facility; and general administrative costs which were segregated and allocated back to the programs beginning in 2002. General administrative costs were incurred and charged against PGC funds

throughout the audit period; however, in 2002 the Commission required that these costs be allocated to the individual programs. SCE did not retain support for the majority of the inter-departmental charges; therefore, examination and testing of these charges was limited. Although our analysis was limited, we identified categories of overhead costs which had been included in base rates, but were incorrectly charged against PGC funds. We recommend that these costs be adjusted.

blueCONSULTING's audit identified some problems with SDG&E's documentation and classification of costs. Rebates and incentives, labor-related overhead charges and costs classified as "Other" are generally adequately supported and properly classified; however, audit tests revealed some departures from program requirements. Documentation of employee labor charges is inadequate. Further, blueCONSULTING is unable to conclude direct labor costs are reasonable and properly classified because of the large number of exceptions in the test sample. SDG&E also provided an inadequate explanation and was unable to support the amount of Material Procurement and Logistics (MP&L) overheads included in the energy efficiency program costs.

In general, based on the documentation provided to blueCONSULTING during the audit, there are problems with SCG's classification of costs and its support of such costs. It is difficult to draw meaningful conclusions because SCG did not retain sufficient electronic records from its early systems after conversion to SAP in a manner useful for testing. SCG's accounting systems from 1998 into 2001 were not adequate to report reliable and accurate information to the Commission. SCG's accounting systems from late 2001 and 2002 also did not support the reporting of information to the Commission at the level of detail that the Commission recommended. SCG does not apportion labor and indirect costs to programs or cost categories with sufficient accuracy as to make program costs meaningful to a reader of its reports on energy efficiency program costs. Labor costs are allocated rather than directly charged. SCG's expenditure accrual process is problematic and the informality surrounding the tracking of expenses and adjustments diminishes the accuracy of expense accumulations. SCG's method for calculating interest charges and credits to the Conservation Expense Account (CEA) differs from the method used by SGD&E, and from the method used by SCG for other balancing accounts. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7.4) million, a difference of (\$8.0) million.

Exhibit V-2 and **Exhibit V-3**, which follow, list blueCONSULTING's findings and recommendations by Utility.

Exhibit V-2: Summary of Conclusions by Utility

Note: Conclusion numbers shown below correspond to the numbers within each utility section. As a result numbers below may not be consecutive.

| Review Area | PG&E | SCE | SDG&E | SCG |
|--------------|---|---|--|--|
| Direct Costs | <p>1. Contract costs represented 39 percent of the energy efficiency costs during the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area</p> <p>2. Incentives represent 34 percent of the energy efficiency costs in the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area.</p> <p>3. PCC labor and non-labor costs are properly distributed to orders based on employee hours charged and the PCC standard rate. Although blueCONSULTING identified some deficiencies in time card documentation, we do not believe these have a material impact on the reported labor charges.</p> <p>4. Energy efficiency labor charges reflect actual payroll costs.</p> <p>7. "Other" costs represent five percent of the total energy efficiency costs in the audit period. blueCONSULTING's review has identified some transactions in this cost category that should be re-classified, but found no costs that were not energy efficiency-related.</p> | <p>14. In general, SCE's direct energy efficiency costs are properly supported and classified. Minor exceptions were noted; however, no material adjustments were identified. Identified adjustments are presented because SCE intends to correct the accounting. Controls over the use of a corporate advertising contract are insufficient to ensure energy efficiency costs are appropriately accounted for.</p> <p>15. Cost controls are inadequate to ensure purchase order limits are not exceeded in a given year. When a program is extended for a new program year, SCE issues a change order to increase an existing PO amount, instead of issuing a new PO. Significant increases are also authorized within a program year. This practice does not allow for adequate monitoring of expenditures.</p> <p>17. During the audit period, SCE's corporate guidelines for the proper use of procurement cards were violated.</p> <p>18. Controls over charges to CTAC and AgTAC should be improved in light of the dual-funded nature of these programs.</p> <p>19. SCE employed two different methods of accounting for expenses and revenues associated with joint-utility programs.</p> | <p>22. Documentation of employee labor charges to energy efficiency programs is inadequate. We are unable to conclude direct labor costs relating to energy efficiency program delivery are reasonable and properly classified in accordance with applicable accounting principles and regulatory requirements because of the large number of exceptions in the test sample.</p> <p>23. SDG&E has properly accounted for energy efficiency employee total compensation. However, distribution of labor charges to energy efficiency programs is not adequately supported.</p> <p>24. In some cases, SDG&E is not receiving adequate value for its expenditure of energy efficiency labor dollars.</p> <p>25. Charges contained in the database of "other" charges are primarily vendor payments. In general, they are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements. However, audit tests reveal a number of departures from program requirements.</p> <p>26. SDG&E has entered into questionable business relationships with two former employees.</p> <p>27. The invoicing and purchase order processes lack adequate controls.</p> <p>28. Charges contained in the Rebates and Incentives database are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements. However, audit tests reveal a number of departures from established corporate policy.</p> | <p>34. blueCONSULTING's ability to audit SCG's energy efficiency costs was hindered because transaction level information for 1998 was not readily available through SAP, and we were provided with little of the requested documentation for other years.</p> <p>36. SCG's expenditure accrual process is problematic, and some significant expenditures had insufficient documentation. The informality surrounding the tracking of expenses, and in particular the reclassification of expenses, diminishes the accuracy of expense accumulation and tracking.</p> <p>37. Program funding and commitments were tracked using spreadsheets and databases, allowing such costs to escape the basic controls of a double-entry accounting system. Program expenditures are tracked in SAP (or BAS), but they are readily adjustable by a number of individuals. This lax accounting environment allows human error to go undetected and unchecked in numerous accounting processes for the program area.</p> <p>38. Several transactions tested were unsupported, had questionable costs or represented costs not related to energy efficiency programs.</p> <p>39. Labor costs for energy efficiency programs are allocated to individual cost elements based on the funding budget created by the Commission and do not reflect the actual activity underlying such costs.</p> |

Exhibit V-2: Summary of Conclusions by Utility

Note: Conclusion numbers shown below correspond to the numbers within each utility section. As a result numbers below may not be consecutive.

| Review Area | PG&E | SCE | SDG&E | SCG |
|---------------------------------|---|--|--|--|
| Indirect/ Allocated Costs | <p>5. blueCONSULTING verified that the non-labor costs charged to PCCs are costs incurred to support the general PCC activities. Our examination of 40 transactions of non-labor costs that were charged to PCCs identified only one exception.</p> <p>6. The majority of PCC-driven costs in PG&E's energy efficiency programs are from PCCs which are directly involved in the execution and support of the programs; however, there are also some charges from PCCs with no direct involvement in energy efficiency activities. We were unable to determine the exact amount of these charges, but we estimate them to be less than \$500 thousand, or .5 percent of PG&E's energy efficiency costs</p> <p>8. blueCONSULTING's analysis indicates that electric burden amounts are correct.</p> <p>9. The \$12.7 million of costs which are custom allocated are appropriately classified as energy efficiency costs and the bases for allocating the costs are reasonable.</p> <p>10. The overhead amounts associated with electric labor were calculated correctly using PG&E's "third party billing rates."</p> | <p>20. SCE charged only three types of overhead costs to the energy efficiency programs during the audit period: interdepartmental chargeback costs, costs associated with one leased facility, and general administrative support costs which were treated as indirect costs beginning in 2002. Approximately \$137,000 of the IMM costs were for categories of costs which were included in base rates and should be adjusted.</p> | <p>29. Labor-related overheads included in energy efficiency program costs are properly supported by current cost allocation studies, and the basis for allocation is appropriate and reasonable.</p> <p>30. SDG&E provided an inadequate explanation and was unable to support the amount of Material Procurement and Logistics overheads included in energy efficiency program costs.</p> <p>31. The cost of employee use of assigned vehicles charged to energy efficiency program costs is reasonable. However, the Company did not adequately answer our request for information regarding the vehicle use rate.</p> <p>32. In addition to the allocated costs discussed above, energy efficiency program costs include certain other direct and indirect costs that might typically be considered overheads.</p> <p>33. Energy efficiency program costs do not include certain other types of indirect costs that might typically be considered overheads.</p> | <p>35. SCG does not have an accurate methodology for cost allocation or direct assignment of costs. The volume of costs allocated, coupled with a lack of an acceptable allocation methodology, compromised the reliability of SCG's reported results.</p> |

Exhibit V-2: Summary of Conclusions by Utility

Note: Conclusion numbers shown below correspond to the numbers within each utility section. As a result numbers below may not be consecutive.

| Review Area | PG&E | SCE | SDG&E | SCG |
|--------------------------|---|---|-------|--|
| | <p>11. Allocated (Clearing) costs include approximately \$255,000 for payroll taxes and benefits which are also included in base rates. This amount should be excluded from PG&E's energy efficiency program costs.</p> <p>12. With the exception of the possible double-counting of payroll taxes and benefit burdens included in allocated (clearing) costs and in PG&E's base rates, there is no double counting between Overhead Costs, Allocated Costs, Payroll Burdens, Custom Allocated Costs, and the Administrative & General Costs included in PG&E's base rates.</p> | | | |
| Balancing Account | <p>13. PG&E's PPPEBA properly reflects the energy efficiency costs recorded in PG&E's accounting system and the energy efficiency revenue requirements authorized by the Commission.</p> | <p>21. Differences between accounting costs and expenditures recorded in the energy efficiency balancing account, EEPAM, result from shareholder incentive costs and adjustments which could not be verified within the audit time frame.</p> | | <p>40. SCG's method for calculating interest charges and credits to the Conservation Expense Account (CEA) differs from the method used by SGD&E, and from the method used by SCG for other balancing accounts. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7,385,565), a difference of (\$7,995,074).</p> |

Exhibit V-3: Audit Recommendations by Utility

| Utility | Recommendations for the Utilities |
|---------|--|
| PG&E | <ol style="list-style-type: none"> 1. PG&E should reclassify the misclassified incentive payments (\$51,000) and adjust the balancing account as necessary to eliminate costs from PCCs that do not support energy efficiency (estimated at less than \$500,000) and \$255,000 of gas labor-driven pension and payroll taxes that are in base rates (See also Recommendations Nos. 4 and 5 below) 2. PG&E should strengthen its controls to ensure that costs are recorded with the correct cost element in SAP. 3. PG&E should correct the algorithm in its timesheets so that when an individual works more than 40 hours per week, there is a consistent basis to reduce actual hours charged to each order to reflect a 40 hour week. 4. PG&E should review the charges to its energy efficiency programs from non-CEM or Account Services PCCs to identify any erroneous charges, even though the amount is small (less than \$500,000). 5. PG&E should make the appropriate adjustments to the balancing account to correct the overstatement of electric burdens. |
| SCE | <ol style="list-style-type: none"> 6. SCE should adjust the balancing account in the amount of \$194,509 to account for incorrect charges identified by the audit. Going forward, an additional accuracy check of the accounting coding should be performed by a financial member of the energy efficiency team, prior to submission of the invoices for processing. 7. If possible, SCE should eliminate the practice of advances for advertising. If not, expenditures against advances should be made within the same program year. 8. Investigate procurement card violations and eliminate cards as necessary. Enforce the requirement that management review purchases for compliance with corporate and CSBU requirements prior to approving purchases. Future abuses should be dealt with promptly. According to SCE, as a result of our audit, procurement cards have been cancelled. 9. The guidelines and methodology used to allocate expenses between PGC and O&M for the CTAC and AgTAC energy centers should be modified to clearly state how the allocations should be handled for all shared expenses. Additional review of CTAC/AgTAC charges should be performed to ensure costs have been accounted for correctly. 10. SCE should retain support for all charges associated with energy efficiency programs, regardless of source, while subject to Commission audits. The base rates determined at the beginning of each year should be documented and supported. All charges to PGC programs should be supported including the calculation of the amount charged. All supporting accounting documentation should be retained. 11. Going forward, human resource/IMM training costs, internet access, desktop and laptop services, telephone services, and radio/communication IMM costs should not be charged to the energy efficiency programs, as these categories of costs were included in the design of base rates. 12. SCE should confirm the validity of the adjustments made to EEPAM in 2000 and 2001. |

Exhibit V-3: Audit Recommendations by Utility

| Utility | Recommendations for the Utilities |
|---------|--|
| SDG&E | <ol style="list-style-type: none"> 13. The Corporate Controller should review current practices relating to WITS system data entry and records retention for energy efficiency labor charges to ensure that future charges are adequately supported. 14. Energy efficiency program management personnel should eliminate the need for payment of overtime premiums to customer services and other personnel asked to staff display booths at community outreach events. Arrangements for compensatory time off from the person's regular assignment might eliminate the overtime situation. 15. SDG&E should enforce its established policies and procedures relating to procurement of energy efficiency goods and services including approval of contracts with former employees by the Semptra Energy Project Review Committee, use of competitive bidding practices, proper documentation for vendor travel and entertainment expenses, approval authorities, and data entry. 16. SDG&E should investigate the reasons for the apparent MP&L discrepancies noted in the audit and make appropriate adjustments, if necessary. |
| SCG | <ol style="list-style-type: none"> 17. SCG should make adjustments to its balancing account to reflect the portion of \$166,000 of website design costs that are not energy efficiency related. It should also reclassify the costs which were erroneously charged to PY 2000. 18. SCG's allocation of labor costs to energy efficiency programs should be recorded based on the actual effort expended on the various cost elements. This would provide accurate information as to the true costs of individual programs and assure the costs are properly reported to the Commission. 19. SCG should develop policies and procedures that will improve the Company's ability to properly classify costs to the program year to which they apply. 20. SCG should develop policies and procedures to charge only the portion of costs that are related to energy efficiency programs to those programs. 21. SCG should overhaul its employee expense reporting policies to bring reporting standards at least to that required by the Internal Revenue Code. That would require that expenditures be backed by a statement of business purpose and a list of persons in attendance with company affiliations and/or titles. Also, a record of the expenditure detail should be kept such that it can be known what was purchased with a credit card charge. 22. SCG should raise the threshold of accountability for reclassifying costs from one internal order (which roughly corresponds to a program) to another. Currently, reclassifications are numerous, large, and not supported by analysis or rationale. The volume of reclassifications threatens the accuracy of the cost data accumulated to specific programs and to specific cost codes. Reclassifications should be made only on the basis of a reasoned statement of the need to reclassify and a written estimate of the amounts, supported by a written calculation. Shifting expenses to match expenses to program budgets should be prohibited, as this is tantamount to fund shifting outside the fund shifting guidelines. |

| Utility | Policy Issues for the Commission |
|---------|--|
| SCG | <p>23. The Commission should review SCG's interest calculation, clarify its position with respect to interest calculation methodologies, and require adjustments as necessary to the CEA account and any other balancing account where a similar calculation methodology was employed.</p> <p>24. The Commission should adopt a standard that any non-GAAP or unusual financial measurement techniques be explicitly stated by the Utility in each report to the Commission where such non-GAAP accounting is incorporated</p> |

B. Background and Approach

1. RFP Task Area

Verify PGC expenditures on energy efficiency-related programs and services.

2. Objectives

- Determine whether direct costs relating to energy efficiency program delivery including labor, non-labor and incentives are properly supported and classified in accordance with applicable accounting principles and regulatory requirements.
- Determine whether indirect costs charged to energy efficiency programs are properly supported by current cost allocation studies, that the basis for allocation is appropriate and reasonable.
- Determine that energy efficiency program costs are properly reported to the Commission in the Company's Annual Reports filed for the Plan Years 1998 through 2002.

3. Audit Procedures

The following procedures were performed in this audit area:

- Reconciled the information contained in the energy efficiency program financial statements provided by each utility to the Annual Reports submitted to the Commission for the years 1998 to 2002. Identified and explained any differences.
- Designed detailed cost testing procedures based on analysis of accounting records.
- For testing of direct costs:
 - ⇒ Stratified transactions in accordance with the selected sampling criteria and selected transactions for testing.
 - ⇒ Traced transactions to supporting documentation.
 - ⇒ Completed transactions checklists.
- For testing of indirect costs:
 - ⇒ Validated the allocation of total costs to the energy efficiency programs.
 - ⇒ Documented the reasonableness of methodologies used and the consistency and reasonableness of results.
- Obtained a listing of costs included in distribution rates from the last General Rate Case/unbundling proceeding. Confirmed that categories of direct and indirect costs included in distribution rates were not also charged to energy efficiency programs.

- Compared treatment of costs charged to the programs versus costs included in distribution rates among utilities.
- Obtained an analysis by year of applicable balancing accounts relating to electric and gas energy efficiency programs.

4. Sampling Techniques

The sampling methodology for each utility is discussed below.

PG&E

All costs were tested, including non-utility programs such as Third Party Initiatives, Summer Initiatives, and 2002 local programs.

Contract Costs

PG&E expended \$182 million in contract costs, comprised of 712 vendors with 1,082 contracts. We obtained a database of vendors from PG&E and selected 118 vendors for testing. Within the vendor sample, we selected 205 transactions. The sampling selection was as follows:

- 34 vendors with over \$1 million in expenditures.ⁱ We selected one invoice for each year the vendor had the highest charges, distributing our selection across the programs. This resulted in the selection of 121 transactions.
- 17 judgmentally selected vendors. We selected one transaction for each vendor, considering the year and assigned orders.
- There are 406 vendors with total amounts between \$1,000 and \$1 million. We selected 67 (15 percent) of these vendors for testing on a random basis. We selected one transaction for each vendor.

Incentive Costs

During the audit period, there were 132,134 SAP incentive transactions totaling \$160.5 million. There are 5 principal SAP document types among the incentive costs.ⁱⁱ We selected a total of 159 transactions from the total population of each of the five document types based on a combination of systematic and random sampling with professional judgment.

PCC-Driven Costs (Labor, Burdens, Other and Allocated Costs)

There were 342 PCCs which contributed \$74.7 million to the energy efficiency costs during the audit period,ⁱⁱⁱ 27 of these PCCs contributed 99 percent of the PCC-driven costs. In order to examine these costs, we selected ten PCCs which contributed 60 percent of the PCC-driven

ⁱ We were first given the vendor database in Document Response PGE-DP-4.3. Subsequently, in Document Response PGE-EAL-12.1, PG&E provided a revised database with three additional vendors with charges over \$1.0 million. Due to timing issues, these vendors were not selected for testing.

ⁱⁱ There are actually 13 different document types, but there are less than 10 transactions in 8 of these types.

ⁱⁱⁱ This amount does not include reversals of erroneous PCC charges.

energy efficiency costs. We examined one month of charges to and from each of these PCCs. Further sampling was employed for each of the ten PCCs as follows:

- We selected five orders with charges from the PCC and examined employee time cards to verify the hours charged to energy efficiency orders.
- We identified charges to the PCC by cost element. We reviewed these costs, and judgmentally selected five cost elements for further testing for each PCC. We then drilled down on these cost elements in SAP and then judgmentally selected specific transactions for further testing by obtaining documentation and explanations from PG&E.
- We examined the development of the standard rate for selected PCCs in years 2001 and 2002. (Because the standard rate variance was allocated to orders in the same way as costs in the period 1998 to 2000, the standard rate itself did not impact costs charged to orders in those years.)

Burden

In addition to the verification of burden amounts in the ten selected PCCs, we tested the electric burden amounts on a global basis using the total burden data from SAP, and the ratio of electric and gas labor based on data in MDSS/Tracker.

Other Costs

Other costs totaled \$25 million and are captured in SAP in 157 separate cost elements. We selected 24 cost elements based on five-year amounts (everything over \$250 thousand) and some cost elements which, in our judgment, may include costs that may not be appropriately classified as energy efficiency costs. We randomly selected 30 transactions for the years 1998 to 2002, covering these cost elements as well as inquired about certain cost elements that may include costs that may not be appropriately classified as energy efficiency costs.

We also selected some of the costs which were ultimately classified as “Other” through the PCC sampling methodology discussed above.

Allocated Costs

We selected some of the costs which were ultimately classified as “Allocated” through the PCC sampling methodology discussed above. There was no other sampling in this area. The nature of clearing costs does not allow the analysis of individual transactions. We performed global analyses to understand the source and nature of these costs.

Overhead Costs

No sampling was employed. We verified overhead costs on a global basis using total electric labor costs and annual overhead rates.

Custom Allocated Costs

There were 37 orders totaling \$15 million that were allocated to other energy efficiency orders during the audit period. (The \$15 million total amount allocated is greater than the amount allocated to Energy Efficiency Programs as some costs are also allocated to CARE and LIEE

programs.) We selected the ten allocated orders with total five-year expenditures over \$500 thousand, as well as four orders which, in our judgment, may include costs that may not be appropriately classified as energy efficiency costs.

SCE

All costs were tested, including non-utility programs such as Third Party Initiatives, Summer Initiatives, and 2002 local programs.

Non-Incentive Costs

Judgmental sampling techniques were employed in the testing of non-incentive costs. Samples were selected for each cost element based on the specific nature of the transactions associated with each cost element. Additional samples were subsequently selected as required, based on the results of our initial testing. Sample counts listed below are transactions as identified by SCE's accounting system, and may include multiple charges. For example, a procurement card transaction may consist of five or ten individual purchase, and incentive payments to certain contractors may consist of hundreds of rebates. **Exhibit V-4** provides an overview of our sampling in this area.

**Exhibit V-4: All SCE Non-Incentive Cost Elements Were Sampled
(Dollars in Thousands)**

| Cost Element | Population Dollars | Sample Size [Note 1] | Discussion | Sample Dollars [Note 1] | Positive Sample Dollars [Note 1] |
|----------------------|--------------------|------------------------------|--|-------------------------|----------------------------------|
| C (Contract) | \$7,750 | 27 | Randomly selected, two significant items were also selected. | \$332 | \$332 |
| I (IMM) | 4,800 | 54 | Selected based on category. | 1,163 | 1,163 |
| M (Materials) | 1,531 | 31 | Randomly selected, additional selections for vendors over \$50k. | 734 | 734 |
| P (Payroll Loadings) | 1 | NA | All costs were adjusted. | NA | NA |
| L (Labor) | 51,114 | 30 employees | Employees were classified in three groups: dedicated energy efficiency personnel; employees who split time between energy efficiency and non-energy efficiency activities; and employees who perform support functions (e.g., internal audit, human resources). Employees were selected from each category, and support for all charges for those employees was requested. | 3,160 | 3,160 |
| | | 41 non-specific transactions | Forty one transactions which were not specific to individual employees were selected for testing | 198 | 353 |
| O (Other) | 130,824 | 341 | Because of the wide variety of costs included in other, costs were segregated into groups: vendors with over \$1 million in total payments (all vendors sampled, multiple years and programs per vendor); vendors with total payments between \$200k and \$1 million (all invoices exceeding \$200k); transactions for which no vendor was specified (judgmental – large dollars and reversals, random selection of employee expenses); remaining transactions (random). | 21,633 | 29,598 |

Note 1: Does not include additional samples selected based on results of initial testing, samples of affiliate transactions or samples selected as part of our review of Accounting Oversight and Funds Management. Positive sample dollars refer to non-negative transactions. Negative entries result from adjustments.

Incentive Costs

Incentives costs are included in Cost Element O (Other), but were sampled separately. Incentives were separated into four groups based on similar characteristics. **Exhibit V-5** provides a description of the incentive sampling methodology.

Exhibit V-5: The Population of SCE Incentives Was Divided into Four Groups for Sampling

| Incentive Group Number | Population Dollars | Sample Size [Note 1] | Discussion | Sample Dollars [Note 1] | Positive Sample Dollars [Note 1] |
|------------------------|--------------------|----------------------|---|-------------------------|----------------------------------|
| 1 | | 83 | Average payment in excess of \$10,000. Random sampling. | \$9,681 | \$10,402 |
| 2 | | 188 | Average payment between \$200 and \$9,999. Random sampling. | (134) | 6,035 |
| 3 | | 110 | Average payment less than \$200. Random sampling. | (124) | 1,183 |
| 4 | | 17 | Judgmental sampling. All prime/subs were selected. | (308) | 1,737 |
| Total | \$129,915 | 398 | | \$9,115 | \$19,357 |

Note 1: Does not include additional samples selected based on results of initial testing, samples of affiliate transactions or samples selected as part of our review of Accounting Oversight and Funds Management. Positive sample dollars refer to non-negative transactions. Negative entries result from adjustments.

SDG&E

Tested costs included non-utility programs such as Summer Initiatives, and 2002 local programs. For each type of expense, **Exhibit V-6** (page following) shows the test sample size as a percentage of the universe of transactions and dollar amounts in that category for the five years of the audit.

To ensure the audit tests of labor transactions provided a complete understanding of the nature of labor charges included in energy efficiency program costs during the audit period, we made judgmental samples in three different ways. Using information obtained during interviews, we identified 15 employees by name who were known to have had specific energy efficiency program responsibilities during the audit period. Next, we selected 25 employees by employee number primarily from energy efficiency Cost Centers, being careful to choose some employees whose labor charges were relatively high and showed continuity during the 1998-2002 audit period, as well as some with relatively low levels of labor charges in only one or two years during the period. Finally, we identified 18 non-energy efficiency Cost Centers with more than \$100,000 in labor charges during the audit period, and we selected one employee from each of these cost centers for detailed testing.

Exhibit V-6: Sampling of SDG&E Costs Was Performed for All Cost Categories

| Category | Transactions to be Tested | Universe of Transactions | % of Universe of Transactions to be Tested | Average Size of Transaction in Universe | Dollars to be Tested | Universe of Dollars | % of Dollars to be tested |
|--------------|---------------------------|--------------------------|--|---|----------------------|----------------------|---------------------------|
| Labor | 109 | 1,055 | 10.33% | \$16,678 | \$1,730,949 | \$25,856,342 | 6.69% |
| R & I | 106 | 74,598 | 0.14% | \$934 | \$2,214,967 | \$69,654,777 | 3.18% |
| Other | 734 | 51,640 | 1.42% | \$1,301 | \$4,769,101 | \$67,184,216 | 7.10% |
| Total | 949 | 127,293 | 0.75% | | \$8,715,017 | \$162,695,335 | 5.66% |

Note 1: The percent of the universe of transactions to be tested is substantially higher for Labor than for R&I and Other. This is explained below:

1) Labor universe was based on the number of “employee years” rather than line item transactions. Each year that an employee was paid from the energy efficiency fund was counted as an “employee year.” 399 employees were paid from the energy efficiency fund in at least one year from 1999-2002. 186 employees were paid in 1998. The 186 employees paid in 1998 may also appear again in the table containing the 1999-2002 data. There were 18 transactions that did not correspond to employees. These 18 transactions were not included when determining the universe of ‘employee months’.

2) The labor sample of 109 “employee months” was derived from a sample of 48 employees. The number ‘48’ may include some overlap, as table 1 in the file from which we sampled contained employee names but no employee numbers and tables 2 and 3 contained employee numbers but not employee names. Table 1 had 15 names.

3) The \$25.9 million universe of labor expenditures included \$8.2 million of charges that did not have corresponding employee numbers or names. These charges are labor related overheads. This was tested 100% applying rates in effect to direct labor dollars and comparing rates across years, after making tests for reasonableness of rates. As a result of this exclusion of overheads in this analysis the proportion of transactions to be tested is higher than the proportion of dollars to be tested.

4) The average transaction size for Labor was derived after excluding overhead charges of \$8.3 million.

Source: blueCONSULTING analysis of databases and test samples.

Selection of Rebate and Incentive transactions for testing were made with three judgmental samples. The first sample selected 97 transactions randomly from the entire Rebate and Incentive database. The second sample was made by selecting transactions from the largest vendors in the database. There were nine large transactions selected in this manner. A final selection of 45 transactions was also made using random selection criteria focusing on one Internal Order (IO) per selected vendor per year. For each of the transactions selected we requested that SDG&E provide all available supporting documentation to include a description of the program, the customer or contractor application, evidence of customer or contractor fulfillment, evidence of required inspections, and documentation supporting the disbursement of funds.

The approach used for testing transactions in the “Other” database was based on segmentation and judgmental sampling techniques. Initially, the “Other” database was segmented, selecting the top 26 vendors in terms of dollar amount of transactions per year. These vendors had transactions with SDG&E that totaled between \$50 thousand and several million dollars over the five-year term of this audit. From this initial segmented database we selected one transaction per vendor per IO per year. This yielded 673 transactions for testing. Additional samples were requested of purchasing card transactions and possible duplicate transactions.

SCG

A three step sampling technique was employed:

- Determine the attributes of the population.
- Determine the appropriate method of stratifying transactions to be tested.
- Determine the use and selection of a process for randomizing transactions selected.

SCG provided the transactional data in the form of 15 databases, three databases for each of the years under audit. The three databases provided for each year were categorized as labor, incentives, and other costs. Each of the databases was analyzed for the number of transactions, the total cost contained in the database, and a calculation of average transaction amount.

In order to stratify and randomize the sample, two techniques were employed. The first drew its sample from the transactions that are of a significant amount and in a large enough quantity to represent 30 percent to 50 percent of the total cost contained in each database. To complete the sample, the auditor, using professional judgment, selected a sample of transactions of particular interest scanned from the remaining un-sampled transactions. This method provided a representative sample of transactions in terms of the number of transactions and total costs.

Exhibit V-7: Sampling of SCG Costs Was Performed for All Cost Categories

| Cost Category | Transactions | | | Dollars | | |
|----------------------|--------------|---------------|-------------|---------------------|----------------------|--------------|
| | Sample | Population | Percentage | Sample | Population | Percentage |
| Other | 141 | 1,203 | 11.7% | \$74,889,119 | \$89,941,923 | 83.3% |
| Rebates & Incentives | 505 | 37,358 | 1.4% | 6,795,598 | 25,406,781 | 26.7% |
| Labor | 100 | 35,603 | .3% | 964,709 | 29,380,401 | 3.3% |
| Total | 746 | 74,164 | 1.0% | \$82,649,426 | \$144,729,104 | 57.1% |

Source: blueCONSULTING analysis of databases and test samples.

C. PG&E

1. Background

PG&E's total expenditures for energy efficiency programs during the 1998 through 2002 audit period were approximately \$466 million, as summarized in **Exhibit V-8**.

**Exhibit V-8: PG&E Energy Efficiency Costs from 1998 to 2002
Were Approximately \$466 Million
(Dollars in Thousands)**

| Cost Category | 5 Year Total | Percent | Brief Description |
|--------------------|------------------|-------------|--|
| Contract | \$181,710 | 39% | Consultants and other contract costs. |
| Incentive | 160,475 | 34% | Rebates and other financial incentives. |
| Labor | 46,458 | 10% | Costs associated with employees who charge time to energy efficiency orders. |
| Other | 25,568 | 5% | Other expenses, including payments to other utilities, postage, rent payments, travel expenses, and cost adjustments. |
| Allocated | 18,167 | 4% | Clearing costs for "chargeback" costs from other organizations such as Engineering or Information Services as well as the "supervisory" costs for the VP and Director – level organizations responsible for energy efficiency. |
| Custom Allocated | 12,732 | 3% | Allocated costs of energy efficiency support functions which do not charge directly to programs. |
| Corporate Overhead | 11,832 | 3% | Corporate overhead rate applied to electric labor. |
| Burden | 8,605 | 2% | Payroll taxes and benefits associated with electric labor 1999 to 2002. |
| Total | \$465,548 | 100% | |

Source: CEE Tracker Reports 1998 – 2002 (Document Response PGE-DP-003.2); blueCONSULTING analysis.

A breakdown of PG&E's energy efficiency costs by program and calendar year is shown in **Exhibit V-9** (page following).

**Exhibit V-9: During the Audit Period, Most of PG&E's Costs Were Incurred in PY 2000 and 73% of the Charges Were for Incentives and Contracts
(Dollars in Thousands)**

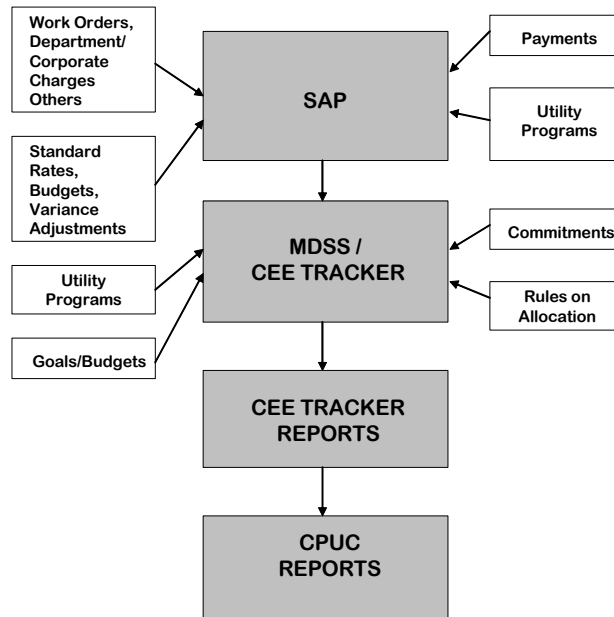
| | 1998 | 1999 | 2000 | 2001 | 2002 | Total | Percent |
|---------------------------|-----------------|-----------------|-----------------|------------------|------------------|------------------|-------------|
| PY 1998 | | | | | | | |
| CONTRACT | \$17,350 | \$4,892 | \$488 | \$47 | \$202 | \$22,979 | 5% |
| INCENTIVE | 7,389 | 3,815 | 2,456 | 913 | 1,941 | 16,514 | 4% |
| LABOR | 8,414 | 1,193 | 39 | 23 | 17 | 9,685 | 2% |
| OTHER | 4,575 | (445) | 76 | (2) | 3 | 4,207 | 1% |
| ALLOCATED | 2,940 | 475 | 22 | 6 | 4 | 3,446 | 1% |
| CUSTOM ALLOCATED | - | 124 | 28 | 15 | 34 | 201 | 0% |
| CORP OH (Elec Only) | - | - | - | - | - | - | 0% |
| BURDEN | - | - | - | - | - | - | 0% |
| TOTAL | \$40,667 | \$10,054 | \$3,110 | \$1,001 | \$2,201 | \$57,032 | 12% |
| PY 1999 | | | | | | | |
| CONTRACT | - | 32,489 | 2,239 | 535 | 343 | 35,606 | 8% |
| INCENTIVE | - | 12,820 | 2,783 | 2,653 | 663 | 18,919 | 4% |
| LABOR | - | 5,588 | 769 | 81 | 51 | 6,489 | 1% |
| OTHER | - | 4,070 | 1,726 | 22 | 246 | 6,064 | 1% |
| ALLOCATED | - | 2,366 | 410 | 51 | 21 | 2,847 | 1% |
| CUSTOM ALLOCATED | - | 397 | 129 | 71 | 20 | 617 | 0% |
| CORP OH (Elec Only) | - | 1,469 | 220 | 31 | 22 | 1,742 | 0% |
| BURDEN (Elect, only) | - | 1,428 | 179 | 20 | 14 | 1,642 | 0% |
| TOTAL | - | \$60,627 | \$8,454 | \$3,466 | \$1,380 | \$73,927 | 16% |
| PY 2000 | | | | | | | |
| CONTRACT | - | - | 42,257 | 18,786 | 6,737 | 67,779 | 15% |
| INCENTIVE | - | - | 15,181 | 28,217 | 7,879 | 51,278 | 11% |
| LABOR | - | - | 9,549 | 1,472 | 177 | 11,198 | 2% |
| OTHER | - | - | 3,964 | (439) | 30 | 3,555 | 1% |
| ALLOCATED | - | - | 3,833 | 772 | 67 | 4,672 | 1% |
| CUSTOM ALLOCATED | - | - | 1,912 | 561 | 246 | 2,719 | 1% |
| CORP OH (Elec Only) | - | - | 2,531 | 572 | 70 | 3,173 | 1% |
| BURDEN (Elect, only) | - | - | 2,053 | 374 | 46 | 2,474 | 1% |
| TOTAL | - | - | \$81,280 | \$50,314 | \$15,252 | \$146,847 | 32% |
| PY 2001 | | | | | | | |
| CONTRACT | - | - | - | \$25,882 | \$9,745 | \$35,627 | 8% |
| INCENTIVE | - | - | - | 44,730 | 15,417 | 60,148 | 13% |
| LABOR | - | - | - | 9,632 | 1,382 | 11,014 | 2% |
| OTHER | - | - | - | 5,050 | 173 | 5,223 | 1% |
| ALLOCATED | - | - | - | 3,719 | 546 | 4,265 | 1% |
| CUSTOM ALLOCATED | - | - | - | 5,291 | 716 | 6,007 | 1% |
| CORP OH (Elec Only) | - | - | - | 3,469 | 511 | 3,980 | 1% |
| BURDEN (Elect, only) | - | - | - | 2,275 | 340 | 2,616 | 1% |
| TOTAL | - | - | - | \$100,049 | \$28,830 | \$128,879 | 28% |
| PY 2002 | | | | | | | |
| CONTRACT | - | - | - | - | \$19,719 | \$19,719 | 4% |
| INCENTIVE | - | - | - | - | 13,617 | 13,617 | 3% |
| LABOR | - | - | - | - | 8,073 | 8,073 | 2% |
| OTHER | - | - | - | - | 6,518 | 6,518 | 1% |
| ALLOCATED | - | - | - | - | 2,936 | 2,936 | 1% |
| CUSTOM ALLOCATED | - | - | - | - | 3,189 | 3,189 | 1% |
| CORP OH (Elec Only) | - | - | - | - | 2,937 | 2,937 | 1% |
| BURDEN (Elect, only) | - | - | - | - | 1,874 | 1,874 | 0% |
| TOTAL | - | - | - | - | \$58,864 | \$58,864 | 13% |
| PY 1998 to PY 2002 | | | | | | | |
| CONTRACT | \$17,350 | \$37,381 | \$44,984 | \$45,250 | \$36,745 | \$181,710 | 39% |
| INCENTIVE | 7,389 | 16,635 | 20,420 | 76,514 | 39,517 | 160,475 | 34% |
| LABOR | 8,414 | 6,781 | 10,356 | 11,208 | 9,700 | 46,458 | 10% |
| OTHER | 4,575 | 3,626 | 5,766 | 4,631 | 6,970 | 25,568 | 5% |
| ALLOCATED | 2,940 | 2,840 | 4,265 | 4,548 | 3,574 | 18,167 | 4% |
| CUSTOM ALLOCATED | - | 521 | 2,069 | 5,937 | 4,205 | 12,732 | 3% |
| CORP OH (Elec Only) | - | 1,469 | 2,751 | 4,073 | 3,540 | 11,832 | 3% |
| BURDEN (Elect. only) | - | 1,428 | 2,232 | 2,670 | 2,275 | 8,605 | 2% |
| TOTAL | \$40,667 | \$70,681 | \$92,844 | \$154,830 | \$106,526 | \$465,548 | 100% |
| Percent | 9% | 15% | 20% | 33% | 23% | 100% | |

Source: CEE Tracker Reports (Document Response PGE-DP-3.2); blueCONSULTING Analysis.

PG&E's Accounting and Cost Tracking Systems

An overview of the systems used by PG&E to track energy efficiency program costs is shown in **Exhibit V-10** below.

Exhibit V-10: PG&E Utilizes Multiple Systems to Track Energy Efficiency Program Costs



PG&E uses SAP as its financial accounting system. The SAP system became operational company-wide in May 1996. SAP is an off-the-shelf software package that has been customized to meet the needs of PG&E. SAP uses cost centers to track costs to provide gas and electric services. A cost center is the lowest unit in the organization for which budgeted and actual costs are collected and accrued. There are two types of cost centers:

- Provider Cost Center (PCC) - represents groups performing work in the organization. PCCs always have employees associated with them.
- Receiver Cost Center (RCC) - represents the company's facilities, assets, products and services.

The service provided by an RCC to a PCC is referred to as activity type. There are service-related activity types (such as maintenance, engineering, consulting, or marketing) and asset utilization activity types (vehicles, facility charges). Major Work Categories (MWC) and Planning Orders are used to break down the work performed at an RCC into meaningful categories. Transactions are coded using order numbers and by detailed cost element showing the nature of a particular entry.

MDSS/Tracker

MDSS is PG&E's primary energy efficiency program cost tracking system. MDSS interfaces with SAP and consists of marketing and contractual databases, analytic tools, forecasting and marketing models, standard reports and graphs. MDSS has over 600 tables and holds four main types of information – Budget, Expenses, Goals and Impacts. Through program codes, dollar components can be viewed by Nodes, PCC, RCC, Work Orders, Cost Elements, Allocations and Exclusions.

For CEE programs, MDSS tracks program participation, provides rebate checks to participating customers and vendors, and provides historical data on energy savings used to justify shareholder CEE earnings.

MDSS Tracking is done via a centralized database. End-users enter and report energy efficiency expense/cost related data via PowerBuilder (developed in-house), MS Access, or SQL*Plus client applications, which run under MS Windows on the internal PG&E network. Some data can be loaded into the system from a flat file data source from a third party.

The CEE Tracker Application serves as a report writer and user interface to MDSS for tracking and monitoring the implementation of energy efficiency programs. The CEE Tracker displays energy efficiency program expenditures, sales and marketing accomplishments on a system-wide basis, and at the division level.

PG&E Energy Efficiency Cost Tracking

PG&E creates specific expense orders for each energy efficiency program authorized by the Commission for each program year. There are several expense orders associated with each program in order to provide detailed information necessary to manage the programs and report costs in the categories prescribed by the Commission. There are almost 1,800 orders comprised of 213 cost elements which contain program costs for the period 1998 to 2002.

MDSS/Tracker pulls cost element level data from SAP and compiles the data into six discrete cost categories based on the cost elements. MDSS/Tracker also calculates the corporate overhead^{iv} and performs custom allocations of certain energy efficiency program support costs associated with each order. As shown in **Exhibit V-11**, PG&E tracks costs in eight cost categories.

^{iv} PG&E included electric corporate overheads in its reported energy efficiency program costs for the period 1999 to 2002. PG&E did not include 1998 electric corporate overheads, nor gas corporate overheads for the entire audit period in its reported energy efficiency costs, as these costs were included in base rates.

Exhibit V-11: SAP and MCSS/CEE Tracker Provide Data for PG&E's Eight Cost Categories

| Cost Category | Data Source |
|--------------------|------------------|
| Labor | SAP |
| Burden | |
| Contract | |
| Incentives | |
| Other | |
| Allocated | |
| Corporate Overhead | MDSS/CEE Tracker |
| Custom Allocated | MDSS/CEE Tracker |

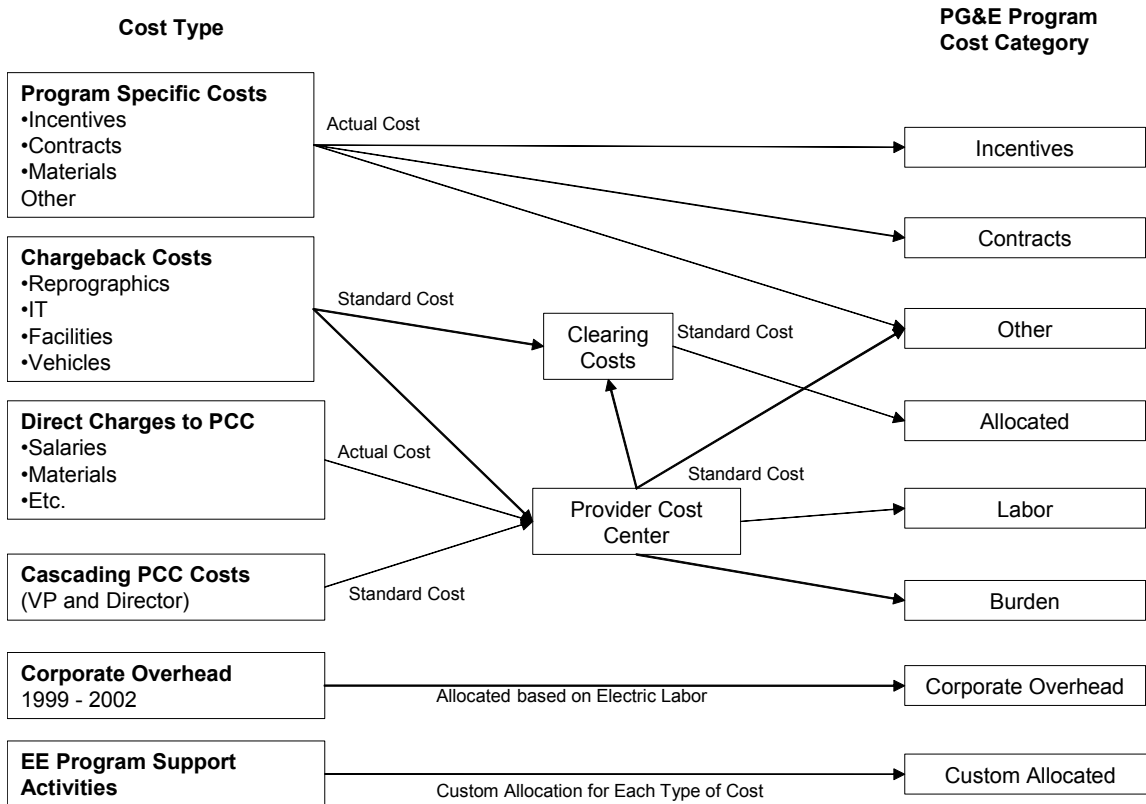
Source: Interview EAL-001; blueCONSULTING Analysis.

There are several cost elements which roll up to each cost category. The addition of Corporate Overheads and custom allocations of certain energy efficiency program support costs are performed in MDSS/Tracker.

The split between electric and gas costs is also performed in MDSS/Tracker, using specific allocations for each energy efficiency program. The allocation between electric and gas is based on the program managers' estimate of the relative amounts of savings which result from each program. If the gas program expenses exceed the gas revenue collected, PG&E would adjust program allocations. However, there has not been a need to adjust the allocated amounts as the program totals are less than the revenues collected and revenue requirements.

PG&E began to track committed costs using MDSS/Tracker in 2001. Prior to 2001, this information was tracked by the program managers. When determining committed costs, PG&E includes a 20 percent adder for labor and administration. There are no commitments made for allocated costs. Allocated costs are included only when actual costs are recorded.

PG&E's energy efficiency accounting process is quite complex. Some costs, such as program incentives and contract costs are charged directly to orders. Other costs, such as labor and PG&E support organization costs, are first charged to PCCs and/or accrued as clearing costs, and then assigned to program orders. An overview of the flow of costs to the various program cost categories is shown in **Exhibit V-12**.

Exhibit V-12: PG&E's Flow of Costs to Program Cost Categories Is Complex

Source: blueCONSULTING analysis based on follow-up discussions regarding cost data provided in numerous data requests.

PCC Costs

Sixteen percent of PG&E's energy efficiency costs in the audit period flow through PCCs.^v As shown in **Exhibit V-13**, these costs include all labor and burden costs, as well as a significant portion of the other and allocated costs.

^v PG&E has several types of PCCs. "Type A" PCCs are the organizations that perform "work in the field." CEM and Account Services personnel involved in the execution of energy efficiency programs belong to Type A PCCs. "Type D" PCCs are Supervisory and Management (Vice President and Director Costs) and "Type E" PCCs are chargeback organizations, such as Information Systems. For simplicity's sake, this report will use the term "PCC" to refer to Type A PCC's and the terms "Supervisory" cost centers to refer to Type D PCCs and "Chargeback Organization" to refer to Type E PCCs.

**Exhibit V-13: 16% of PG&E's Energy Efficiency Costs Flow through PCCs
(Dollars in Thousands)**

| | Total EE Costs | PCC Costs | % PCC Charges |
|---------------------------------|------------------|-----------------|---------------|
| Labor | \$46,458 | \$46,573 | 100% |
| Burden [Note 1] | 8,605 | 8,605 | 100% |
| Contract | 181,710 | 1,016 | 1% |
| Incentives | 160,475 | (20) | 0% |
| Other | 25,568 | 8,087 | 32% |
| Allocated (clearing) [Note2] | 18,167 | 10,439 | 57% |
| Corporate Overhead | 11,832 | - | 0% |
| Custom Allocated | 12,732 | - | 0% |
| Total | \$465,548 | \$74,700 | 16% |

Note 1: SAP Burden amounts provided in Document Response LLD-006 total \$12,308 and include both electric and gas burdens. \$8,605 is the electric burden amount based on CEE Tracker Reports.

Note 2: Allocated (clearing) costs include costs for office services, facilities, and IT support, support labor and benefits, as well as the "cascading costs" of the VP and Director-level organizations.

Source: CEE Tracker Reports 1998 – 2002 (Document Response PGE-DP-003.2);
Type A PCC Charges (Document Response PGE-LLD-006)-blueCONSULTING Analysis.

PCC costs are charged to an order based on the PCC standard rate and the number of hours charged to that order by PCC employees. PCC standard rates are developed annually based on projected labor, material, and other costs, and projected billable hours. A standard rate may be changed during the year if there are significant deviations from the original assumptions used to develop the rate. An example of PCC standard rate development is shown below in **Exhibit V-14**.

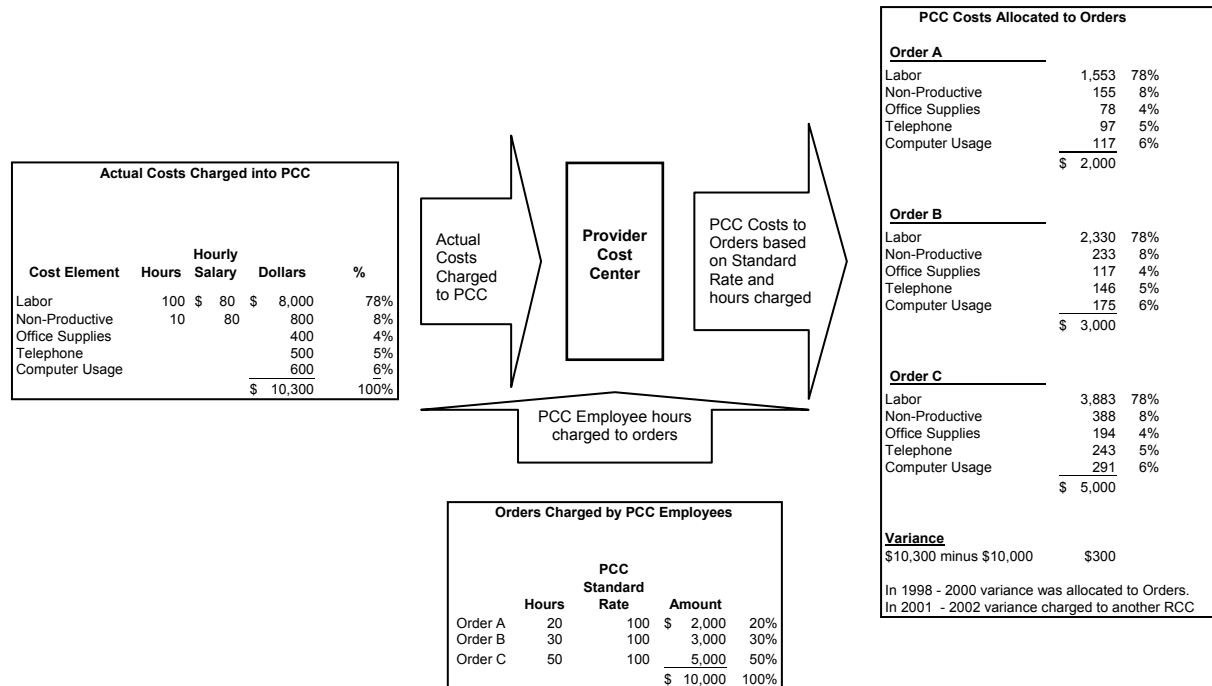
**Exhibit V-14: Sample PCC Standard Rate Development Is Based on Projected Labor, Material,
Other Costs, and Projected Billable Hours**

| Cost Type | Costs | Hours |
|-----------------------------|--------------------|---------------|
| Direct Labor | | |
| Productive Labor | \$1,703,469 | 47,463 |
| Non Productive Labor | 319,894 | 8,913 |
| Premium Pay | 29,466 | |
| Payroll and Benefit Burdens | 612,730 | |
| Total Labor | \$2,665,559 | 56,376 |
| Materials | \$13,500 | |
| Materials Burden | 1,575 | |
| Contracts | 20,277 | |
| Employee Related and Other | 35,321 | |
| Fleet | 18,210 | |
| Facility Charge | 2,271 | |
| Internal Services | 73,400 | |
| Supervision & Management | 84,142 | |
| Total Costs | \$2,914,255 | |
| Total Billable Hours | | 39,463 |
| Estimated Standard Rate | \$74 | |
| Capacity Factor | | 70% |

Source: Sample PCC Standard Rate Calculation (Document Response PGE-LLD-005.1).

As illustrated in **Exhibit V-15**, costs are assigned to orders based on the number of hours charged and the PCC standard rate, and to specific cost elements in proportion to each cost element's relative contribution to the monthly PCC actual costs.

Exhibit V-15: Costs Are Assigned to Orders and Specific Cost Elements



Source: blueCONSULTING analysis and follow-up discussions regarding cost data provided in numerous data requests.

Monthly employee charges to PCCs include the following:

Exhibit V-16: Monthly Employee Charges to PCCs Include Both Non-Labor Expenses and Labor Hours

| Expense Type | Expense Charge |
|--------------------|---|
| Non-Labor Expenses | <ul style="list-style-type: none"> Expense Accounts (not for a specific meeting) Training (Outside consultant, lodging, meals) Pool car usage Business cards Small repro jobs (not specific to a program) Individual building and land requests Performance awards Monthly charges from ISTS (telephone, telephone usage, cell phones, pagers, computers) |
| Labor Hours | <ul style="list-style-type: none"> Training Reading emails Staff meetings Other administrative meetings General administrative tasks |

Source: PG&E Training Material-"Budget (or SAP) for Smarties" (PG&E Document Response EAL-3.2)

PCCs also receive supervisory costs and other costs from chargeback organizations as further discussed below.

SAP tracks the monthly variance between the actual PCC costs and the costs distributed to the orders using the standard rates. In the years 1998 through 2000, SAP allocated this standard variance to orders in the same manner as other costs. Beginning in 2001, PG&E began to record all variances incurred each month by PCCs in separate variance orders, which were no longer distributed by SAP to orders charged by the PCC during a given month. In 2001 and 2002, PG&E allocated the standard variance of certain energy efficiency-related PCCs to energy efficiency orders through its custom allocation process.

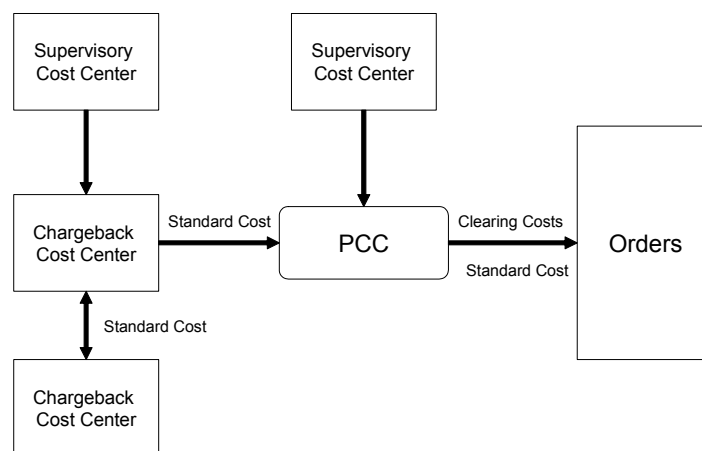
Supervisory Cost Centers, Chargeback Cost Centers and Clearing Costs

Costs from supervisory cost centers and chargeback organizations are captured in “clearing” accounts in SAP. PG&E has used the clearing cost concept to charge-out fleet and material costs for decades. With the implementation of PG&E’s SAP business system in 1996, the clearing cost concept was extended to include other high volume internal charging departments such as: engineering, facilities use, information systems, office services, stores, transportation and equipment, training, and supervision.

In general, clearing costs are based on standard charges. In 2001, PG&E implemented a new feature of the clearing functionality within SAP that allowed for the identification of labor dollars embedded in the standard cost charge.

An overview of the flow of chargeback and supervisory costs to PCCS and orders is shown in **Exhibit V-17**.

Exhibit V-17: Chargeback and Supervisor Costs Flow From Supervisory Cost Centers to Chargeback Cost Center and PCC



Source: Interview regarding Type E PCCs and Clearing Costs (Document Response PGE-EAL-34.5); Description of Clearing Costs (Document Response PGE-EAL-34.4)

2. Summary of Adjustments

A summary of the types of questioned and potentially misclassified costs is shown in **Exhibit V-18**.

Exhibit V-18: Questioned and Potentially Misclassified Costs Identified in Audit

| Cost Category | Transfer to Incentives | Exclude from Energy Efficiency Cost | Ref. Conclusion Number |
|---------------|---|--|------------------------|
| PCC Costs | | Costs from PCCs that do not support energy efficiency and are not cascading costs | C6 |
| Other | Misclassified incentive payments: \$50,919 | | C7 |
| Allocated | | \$255,000 of gas labor-driven pension and payroll taxes that are also in base rates. | C11 |

3. Conclusions

C1. Contract costs represented 39 percent of the energy efficiency costs during the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area.

- The results of blueCONSULTING's detailed testing of sample contract documents are summarized in **Exhibit V-19**.
- As shown in Exhibit V-19, there were a relatively small number of instances in which PG&E was not able to provide us with adequate supporting documentation. According to PG&E, the inability to produce all requested documentation may be due to misplaced documents or difficulty in retrieving documents from the early part of the audit period. Most of the documents we tested were archived and/or stored in several locations outside the PG&E Main Office.

Exhibit V-19: Exceptions Identified in Detailed Testing of Contract Transactions

| Exception | Number of Transactions | Percent of Sample |
|---|------------------------|-------------------|
| Lack of evidence of compliance with review and approval processes | | |
| No approval signature was noted on pre-December 2001 invoices (prior to implementation of SAP online approval). | 8 | 4% |
| Inadequate supporting documents | | |
| No copy of contracts was provided. | 24 | 12% |
| No copy of cancelled checks was provided. | 5 | 2% |
| No copy of invoices was provided. | 8 | 4% |
| Names on invoice and on cancelled check did not match. | 2 | 1% |
| Names on invoice and on SAP contract costs listing did not match. | 2 | 1% |
| The photocopy of invoice did not clearly indicate the date. | 1 | 0% |

Source: Sample Contract Transactions (Document Response PGE-EAL-018); blueCONSULTING analysis.

- Only four percent of the sampled transactions did not have the requisite signature indicating payment authorization. CEM required a signature on invoices approved prior to 2001, whereas other PG&E departments did not always require a signature on the invoice. The CEM approval process is summarized as follows:
 - ⇒ The program manager reviewed invoices to verify that there is an approved purchase order/contract and to confirm that the services have been performed or goods were received.
 - ⇒ Prior to December 2001, the program manager approved the invoices manually with an approval signature and returned the invoice to the Invoice Desk, where the CEM Support Staff posted the Goods Receipt (GR).
 - ⇒ Invoice processing for the CEM Department was revised in December 2001. All invoices were first received at the Invoice Desk and then distributed to the program managers for approval. The program manager approved the invoice online, by posting a goods receipt in SAP. On occasion, the Invoicing Desk staff would post a goods receipt if the program manager was not available, but first documentation of the program manager's approval (in the form of electronic mail or actual signature on the invoice).
 - ⇒ The Payment Processing Department pays the invoices with matched GR only. The invoices will not be paid if there is no GR posted as it indicates that PM's review and approval has not yet been completed.
- blueCONSULTING's detailed review of 205 vendor transactions identified just one transaction which was improperly classified as a contractor cost:
 - ⇒ A \$170,000 payment to a contractor for reimbursement of the incentive payments to a manufacturer of Compact Fluorescent Light (CFL) bulbs. According to PG&E, in 1999, Compact Fluorescent Light incentives were paid by a contractor, and the

payment was properly classified as a contractor payment. It is blueCONSULTING's assessment that this is more appropriately classified as an incentive payment.

⇒ blueCONSULTING also identified nine transactions for which some or the entire amount should have been classified as an incentive. According to PG&E, these were payments for prior years' programs, and the incentive was properly reported in the AEAP Annual report as an incentive payment.

- blueCONSULTING performed global analysis of SAP data to identify any other costs which might have been misclassified as energy efficiency contract costs. The un-audited results of our database analysis indicates that 26 SPC incentive payments totaling \$615,321 were classified as contract costs. PG&E had reclassified \$462,066 (or 75 percent) of these costs as incentive payments through journal entries prior to the audit.

C2. Incentives represent 34 percent of the energy efficiency costs in the audit period. Although our detailed testing identified some minor exceptions, we have no significant concerns in this area.

- The results of blueCONSULTING's detailed testing of sample contract documents are summarized in **Exhibit V-20**. There were a relatively small number of instances in which PG&E was not able to provide us with all requested supporting documentation; however, there was sufficient documentation for us to understand the nature of the cost. As explained earlier, the inability to produce all requested documentation may be due to misplaced documents or difficulty in retrieving documents from the early part of the audit period.

Exhibit V-20: Exceptions Identified in Detailed Testing of Incentive Transactions Were Due to Lack of Evidence of Compliance and Inadequate Supporting Documentation

| Exception | Number of Transactions | Percent of Sample |
|--|------------------------|-------------------|
| Lack of evidence of compliance with review and approval processes | | |
| No evidence of review on application form was noted. | 8 | 5% |
| Inadequate supporting documents | | |
| No copy of application form or contract was provided. | 17 | 11% |
| No evidence of inspection was noted. | 15 | 9% |
| No copy of cancelled check was provided. | 9 | 6% |
| Amount per check and per invoice does not match. | 2 | 1% |
| No customer's signature appeared on application form. | 1 | 1% |
| Name on check and on application form did not match. | 1 | 1% |

Source: Sample Incentive Transactions (Document Response PGE-LLD-002); blueCONSULTING Analysis.

C3. PCC labor and non-labor costs are properly distributed to orders based on employee hours charged and the PCC standard rate. Although blueCONSULTING identified some deficiencies in time card documentation, we do not believe these have a material impact on the reported labor charges.

- blueCONSULTING's testing verified PG&E's development and application of the PCC standard rate, and the determination of the standard rate variance.
 - ⇒ blueCONSULTING reviewed the bases used in the planning, development and the calculation of standard rates for selected PCCs and found no exceptions.
 - ⇒ Standard rates for each PCC are consistently used for all employee charges to each PCC at one period (month) representing the calculated billed-out costs.
 - ⇒ The recalculated standard rate variance represents the difference between the billed-in and billed-out costs.
- There are differences between the hours reported on employee time sheets and the hours charged to the various orders in SAP. However, it appears that these differences are not a significant concern. There are two principal reasons for the differences:
 - ⇒ CEM employees are encouraged to record all hours worked, but the Phoenix time reporting system does not allow input in excess of 40 hours per week into SAP. There is no consistent basis of reducing the actual hours to reflect the maximum of 40 hours. There is an algorithm in the timesheets which proportionally reduces the time in excess of 40 hours. In some cases the algorithm has become corrupted and the time keeper reduces the hours manually. The hours per Phoenix System represent the hours as input to the SAP System.
 - ⇒ Timesheets are not always released to SAP for the month they represent.
- blueCONSULTING's review of employee time sheets identified several time sheets with no evidence of approval and employee signature, and time sheets which were approved a year late.

C4. Energy efficiency labor charges reflect actual payroll costs.

- Labor costs total \$46.5 million and are comprised of 15 discrete cost elements as shown in **Exhibit V-21**.

**Exhibit V-21: PG&E Energy Efficiency Program Labor Costs Total Approximately \$46 Million
During the Audit Period
(Dollars in Thousands)**

| Cost Element Description | 1998 | 1999 | 2000 | 2001 | 2002 | Grand Total |
|--------------------------|----------------|----------------|-----------------|-----------------|----------------|-----------------|
| Labor – Prod ST | \$6,840 | \$5,405 | \$8,251 | \$9,129 | \$- | \$29,625 |
| Labor - Hiring Hall | 98 | 47 | 55 | 113 | 49 | 363 |
| Labor - Premium Pay | 22 | 95 | 73 | 196 | 42 | 427 |
| Labor – Prod OT | 50 | 103 | 54 | 79 | - | 287 |
| Labor – Prod Dbl OT | 2 | 1 | 1 | 0 | - | 3 |
| Labor-Hiring Hall OT | 0 | 0 | 1 | 1 | 0 | 2 |
| Labor – Prod ST BU | - | - | - | - | 658 | 658 |
| Labor – Prod ST NBU | - | - | - | - | 7,359 | 7,359 |
| Labor – Prod OT BU | - | - | - | - | 10 | 10 |
| Labor – Prod OT NBU | - | - | - | - | 13 | 13 |
| Labor-Prod Dbl OT BU | - | - | - | - | 0 | 0 |
| Labor-Prod Dbl OTNBU | - | - | - | - | 0 | 0 |
| Vacation | - | - | - | 848 | 781 | 1,630 |
| Other Non- Productive | - | - | - | 842 | 787 | 1,629 |
| Non Prod Time-Burden | 1,402 | 1,129 | 1,921 | - | - | 4,453 |
| Total | \$8,414 | \$6,781 | \$10,356 | \$11,208 | \$9,700 | \$46,458 |

Source: Data Response PGE-3.2, blueCONSULTING Analysis.

- As described earlier, labor costs are billed into PCCs, and then they are charged out to energy efficiency orders based on the hours charged by each employee. Labor charges to an order do not reflect the actual salary and labor type (such as straight time, non-productive, or vacation) of each individual employee, but the average salaries of all the employees in the PCC as reflected in the standard rate, and the average distribution of labor types for all PCC employees.
- In 2001 and 2002, there might be a slight variance between actual labor costs and the labor costs charged to each order as the standard variance is no longer allocated directly to orders. As discussed further in Conclusion C9, the standard variances for CEM PCCs are distributed to orders through the custom allocation process; the costs are just not reflected in the actual cost elements.
- In the period 1998 through 2000, cost variances were distributed to the various orders and cost elements in the same proportion as standard rate costs, so the values reflected for each cost element generally reflect actual costs (there was a 2 percent tolerance before a variance was reviewed).
- blueCONSULTING verified that the monthly labor charges to each PCC reflect the actual payroll costs shown in the Labor Detail Query reports from the PG&E's Human

Resources department. The Labor Detail Query reports show the individual employee's time charges by date for each month and the corresponding payroll costs.^{vi}

C5. blueCONSULTING verified that the non-labor costs charged to PCCs are costs incurred to support the general PCC activities. Our examination of 40 transactions of non-labor costs that were charged to PCCs identified only one exception.

- The charges to a PCC are not for the direct support of energy efficiency programs, but are in general support of the PCC. As explained in the background section, these charges, as well as labor costs, are allocated to various orders based on the number of hours charged by the PCC employees.
 - ⇒ Many of the costs charged to PCCs do not have supporting documentation but are based on factors such as the square footage used by the PCC, the number of computers, or the number of hours service is provided. Examples of such charges include:
 - Base facility charges
 - Local Area Network (LAN)/Wide Area Network (WAN) infrastructure fees
 - Pony Express (internal mail delivery).
 - ⇒ Other charges are not “routine” charges (such as facility charges), but still have no documentation other than that provided in SAP. Examples of such charges include:
 - Consulting Services (technical support)
 - Overnight lodging at PG&E's training facilities
 - Non-cash rewards – such as a restaurant gift certificate
 - Purchasing card expenses
 - Training charges (facilities charge, training, overnight lodging).
- blueCONSULTING's examination of 40 transactions of non-labor costs that are charged to PCCs which charge to energy efficiency programs identified only one exception. In one of the months examined there was a \$50 mistaken charge of diesel fuel to a CEM PCC.

^{vi} Although we were unable to review employee data due to confidentiality concerns, we did review an electronic file of the Labor Detail Query reports with summation showing the individual employee's time charges and the gross pay for the month. PG&E maintains that the gross pay agreed with the payroll data obtained from the Human Resource Department. The employee's cost for each month included also car allowances and other expenses or adjustments.

C6. The majority of PCC-driven costs in PG&E’s energy efficiency programs are from PCCs which are directly involved in the execution and support of the programs; however, there are also some charges from PCCs with no direct involvement in energy efficiency activities. We were unable to determine the exact amount of these charges, but estimate them to be less than \$500,000, or 0.5 percent of PG&E’s energy efficiency costs.

- As discussed earlier, 342 PCCs charged approximately \$74.7 million to energy efficiency orders. 27 of these PCCs are CEM and Account Services organizations that contributed 99 percent of the PCC-driven costs. The remaining 315 PCCs, with costs totaling \$701,000, do not all appear to be directly energy-efficiency related.
- blueCONSULTING’s analysis indicates that PG&E has identified and corrected some of these charges (the reversals were not apparent in the PCC data provided due to the treatment of PCC charge reversals in SAP), however there may be additional costs which were charged to energy efficiency orders in error. There are also charges which hit energy efficiency orders as they cascade down from one PCC to another which then has legitimate charges to energy efficiency.
 - ⇒ As previously shown in Exhibit V-17, there are instances in which costs “cascade” from one PCC to another.
 - ⇒ For instance, the PCC costs of the Vice President ultimately responsible for Customer Energy Management (CEDM) “cascade” to the Director of CEM, and then to the PCCs of the subordinate PCCs, such as the PCCs for Residential or Business Energy Management, which charge directly to energy efficiency orders. Non-energy efficiency-related costs incurred by the Vice President PCC “cascade” to the energy efficiency orders through the PCC process.
- blueCONSULTING requested an explanation for a selected sample of 10 PCCs which it considered to be “questionable.” PG&E’s response, and blueCONSULTING’s assessment are shown in **Exhibit V-22** (page following).
 - ⇒ PG&E has already identified four of the ten PCCs as erroneous charges, and booked corrections one or two months after the initial charge was booked to SAP.
 - ⇒ Three of the PCC charges to energy efficiency orders were the result of “cascading” PCC charges.
 - ⇒ Two of the PCC charges were booked directly to the energy efficiency order. While PG&E states that the nature of the charges could not be determined, it is blueCONSULTING’s assessment that it is possible that these are costs which were incorrectly charged to energy efficiency orders.
- It is difficult to determine the total impact of the “cascaded” costs which are not energy efficiency-related. There are 290 PCCs which charged less than \$5,000 to energy efficiency programs during the audit period. (The total amount is \$151,000; 238 of these

PCCs charged less than \$1,000 in the five-year period). It is likely that most of these smaller charges are due to the “cascading” effect of charges from one PCC to another or possible incorrect charges.

Exhibit V-22: PG&E Explanation of a Selected Sample of Questionable PCC Charges to Energy Efficiency Programs

| PCC Description | Amount Charged | PG&E Explanation | blueCONSULTING Assessment | | |
|--|-----------------|--|----------------------------------|--------------|------------------------------------|
| | | | Corrected by PG&E Prior to Audit | Cascaded PCC | Possibly Incorrect Charge to Order |
| Construction Management | \$34,019 | Booked directly to energy efficiency order. It is a valid EE expense associated with Power PACT pilot program. | | | |
| SJ OM&C Support Services | 19,098 | Booked to Smarter Energy Line PCC, then “cascaded” to other orders. | | ✓ | |
| Low Income Programs | 13,680 | It is possible personnel from this PCC worked on energy efficiency program. | | | |
| New Grid Business Ventures | 7,306 | Reversed charges. | ✓ | | |
| Helms Maintenance Foreman | 5,945 | Reversed charges. | ✓ | | |
| ETEC - Line Engineering | 2,555 | Booked directly to energy efficiency order and also to another PCC, then “cascaded” to other orders. Nature of charges could not be determined | | ✓ | ✓ |
| CC Electric Construction | 1,828 | Reversed charges. | ✓ | | |
| LP Meter Reading | 1,731 | Booked directly to energy efficiency order. Nature of charges could not be determined. | | | ✓ |
| Safety Health and Claims - Third Party | 1,664 | Reversed charges. | ✓ | | |
| Aircraft Support | 1,363 | Booked to another PCC, then “cascaded” to energy efficiency orders. | | ✓ | |
| Total | \$89,188 | | | | |

Source: PG&E Explanation of Selected PCC charges (Document Response PGE-EAL-22); PG&E Verification Response, April 7, 2004; blueCONSULTING Analysis.

C7. “Other” costs represent five percent of the total energy efficiency costs in the audit period. blueCONSULTING’s review has identified some transactions in this cost category that should be re-classified, but found no costs that were not energy-efficiency related.

- An overview of the types of costs included in cost category “Other” is presented in **Exhibit V-23**. There are 157 cost elements in this category. blueCONSULTING has grouped these cost elements by cost type for the purposes of this report. 32 percent of “Other” costs are costs which are not charged directly to energy efficiency programs, but flow through PCCs.

**Exhibit V-23: Cost Elements Included in Cost Category “Other” Were Approximately \$26 Million During the Audit Period
(Dollars in Thousands)**

| Cost Type (blueCONSULTING Assessment) | Five-Year Total | PCC Total | Non-PCC Amount | Percent of Total | Percent PCC |
|--|----------------------------|------------------|---------------------------|-----------------------------|------------------------|
| Other Expenses (PG&E Cost Element) | \$6,753 | \$131 | \$6,622 | 26% | 2% |
| Rents | 3,705 | 38 | 3,666 | 14% | 1% |
| Print Materials ,Signs | 2,685 | 103 | 2,581 | 11% | 4% |
| Standard Cost Variance | 2,181 | 2,175 | 6 | 9% | 100% |
| Meals and Travel | 1,888 | 840 | 1,048 | 7% | 44% |
| Matl Not Othr Class | 1,776 | 109 | 1,667 | 7% | 6% |
| Cost Adjustments, Transfers | 1,653 | 75 | 1,577 | 6% | 5% |
| Dues and Membership Fees | 1,435 | 17 | 1,418 | 6% | 1% |
| Adv Exp - Operating | 1,389 | - | 1,389 | 5% | 0% |
| Postage | 1,310 | 155 | 1,155 | 5% | 12% |
| Telephone, Cell Phone, Pagers | 798 | 552 | 246 | 3% | 69% |
| Measuring Instrument | 540 | 0 | 540 | 2% | 0% |
| Car Allowance and Automotive | 448 | 442 | 7 | 2% | 98% |
| Purchasing Card | 441 | 266 | 175 | 2% | 60% |
| Office Supplies | 420 | 219 | 201 | 2% | 52% |
| Rewards (PCC use) | 313 | 294 | 20 | 1% | 94% |
| Computers & Parts | 304 | 68 | 236 | 1% | 22% |
| Interdepartmental Gas and Electric | 203 | 174 | 29 | 1% | 86% |
| Lighting Fixtures | 166 | 0 | 166 | 1% | 0% |
| Subscriptions | 126 | 11 | 115 | 0% | 9% |
| Building-Utilities | 85 | 58 | 27 | 0% | 68% |
| Materials Burden | 58 | 58 | 0 | 0% | 100% |
| Software | 47 | 4 | 42 | 0% | 9% |
| Donations | 41 | - | 41 | 0% | 0% |
| Permits/Fees | 23 | 7 | 16 | 0% | 32% |
| Freight | 8 | 1 | 7 | 0% | 17% |
| Miscellaneous Support Charges | (310) | 2,075 | (2,385) | -1% | |
| Variance PCE | (459) | 216 | (675) | -2% | |
| Reimburse Electric Rev | (2,459) | - | (2,459) | -10% | 0% |
| Total | \$25,568 | \$8,087 | \$17,481 | 100% | 32% |

Source: Type A PCC Charges (Document Response LLD-006); Energy Efficiency Costs by Cost Element (Document Response PGE-DP-3.2 Follow-up); blueCONSULTING analysis.

- Costs which are largely PCC-driven include:
 - ⇒ PCC standard cost variance
 - ⇒ Telephone and pager costs
 - ⇒ Car allowances and other automotive expenses
 - ⇒ Office supplies
 - ⇒ Utilities.

- Costs which are mostly charged directly to orders include:
 - ⇒ Rent (paid to an outside organization)
 - ⇒ Printing
 - ⇒ Advertising
 - ⇒ Membership and Dues
 - ⇒ Other Expenses.
- \$6.8 million of costs (26 percent of the “Other” costs) are in the cost element “Other Expenses.” The greatest contributors to these costs are payments to SCE (e.g., payments for utility-administered statewide programs), the California Energy Commission (CEC) and the Commission. Other costs included in this category are employee expense reimbursements and payments to trade organizations. blueCONSULTING’s review indicates this cost element includes some incentive costs.
 - ⇒ Our testing of sample transactions identified four transactions totaling \$50,919 which should be classified incentives.
 - ⇒ Based on the sample results, we performed a global-level database analysis of the “Cost Element – Other” transactions, and identified 122 transactions in August 2001 (and one transaction in December 2001) which total \$60,700 and are listed as “CUSTOMER ENERGY EFFICIENCY REBATES.” PG&E identified these costs as misclassified incentive costs prior to this audit, and these charges were appropriately treated as incentive costs for regulatory reporting purposes. An adjustment was not made in SAP to change the cost element because the books were closed on SAP for 2001 when this was noticed.
- There is no supporting documentation for many charges to cost elements included as “Other.” For example, other than print-outs from SAP, no supporting documents for expenses charged to “cash rewards-PCC use,” telephone usage,” “cell phone,” and “purchasing card” were provided.

C8. blueCONSULTING’s analysis indicates that electric burden amounts are correct.

- As explained earlier, PG&E includes electric burden and overhead amounts for the period 1999 through 2002 as PG&E did not include recovery of the estimated labor-driven benefit and payroll tax costs and corporate overheads in the 1999 GRC for electric customer energy efficiency DSM expense (PG&E’s base revenue request in the 1999 GRC did include the gas CEE/DSM expense).

- The benefit and payroll tax burden rates are provided annually by PG&E's budget department and are applied in the SAP system based labor amounts as shown below:

Exhibit V-24: Application Basis of Benefit and Payroll Tax Burden Rates

| Burden | Basis |
|---------------|---|
| Benefits | Productive Straight Time Officer Labor |
| Payroll Taxes | Productive Straight Time Labor Overtime and Double Overtime Labor Officer Labor Hiring Hall Hiring Hall Premium |

Source: Components of Billable Costs based on Standard Costs (Document Response PGE-IDR-1.19).

- The burden costs reported by SAP reflect both gas and electric amounts. Separation of costs into gas and electric components is performed in MDSS/Tracker.
- blueCONSULTING assessed the general reasonableness of the electric burden amounts reported in MDSS/Tracker by comparing the electric burden percentage of total burden to the electric labor percentage of total labor. As shown in **Exhibit V-25**, the electric burden amounts reported in MDSS/Tracker properly reflect only the electric labor.

Exhibit V-25: The Electric Burden Amount Properly Reflects the Electric Labor Costs (Dollars in Thousands)

| | 1999 | 2000 | 2001 | 2002 |
|---|----------------|----------------|----------------|----------------|
| SAP Amount (Electric and Gas) | | | | |
| Benefits Burden | \$1,209 | \$1,915 | \$2,186 | \$1,878 |
| Payroll Tax Burden | 578 | 815 | 921 | 795 |
| Total Burden | \$1,787 | \$2,731 | \$3,108 | \$2,674 |
| MDSS/Tracker Amount (Electric Only) | | | | |
| Electric Burden | \$1,428 | \$2,232 | \$2,670 | \$2,275 |
| Comparison of Tracker-Calculated Electric Burden Percentage with Electric Labor Percentage | | | | |
| Tracker Burden % of Total SAP Burden | 80% | 82% | 86% | 85% |
| Electric Labor % of Total Labor Costs | 83% | 82% | 86% | 85% |
| Difference | 3% | 0% | 0% | 0% |

Source: MDSS/Tracker Data Provided in Document Response PGE-DP-3.2; SAP Data Provided in PGE-DP-3.2 Follow-up, Additional 1999 Benefit and Clearing Cost Data Provided in Document Response PGE-EAL-023; blueCONSULTING Analysis.

C9. The \$12.7 million of costs which are custom allocated are appropriately classified as energy efficiency costs and the bases for allocating the costs are reasonable.

- The orders that are custom allocated to energy efficiency programs are costs for activities in support of the energy efficiency programs as well as for LIEE, CARE and SBX1 5 activities. A summary of the costs which are custom allocated is shown in **Exhibit V-26**.

**Exhibit V-26: 1999-2002 Custom Allocated Costs Were Approximately \$15.6 Million
(Dollars in Thousands)**

| Description | 1999 | 2000 | 2001 | 2002 | Total |
|---|---------------|-----------------|----------------|----------------|------------------------------|
| MDSS/Tracker Support | \$842 | \$684 | \$941 | \$1,282 | \$3,749 |
| Marketing Processing Center Management | 18 | 85 | 348 | 266 | 717 |
| CEE Program Support-Risk Management | - | 19 | 64 | 16 | 99 |
| CEE Program Support-Contracts | - | 549 | 685 | 790 | 2,024 |
| CEE Program Support-Planning & Coord | - | 96 | 134 | 347 | 577 |
| CEE Program Communications, Budget & Expenditures | - | 286 | 390 | 351 | 1,026 |
| Reg & Eval Planning & Support | - | 872 | 1,814 | 1,542 | 4,229 |
| Selected PCC Standard Variances | - | - | 1,179 | 593 | 1,773 |
| Information Services CEM Support | - | - | 1,095 | 151 | 1,246 |
| 2002 AEAP for PY 2001 - Expenditures | - | - | - | 72 | 72 |
| Non IOU 2002 Local Programs Admin | - | - | - | 40 | 40 |
| Total | \$ 860 | \$ 2,591 | \$6,650 | \$5,450 | \$15,551 [Note 1] |

Note 1: The total exceeds \$12.7 allocated to energy efficiency programs as some costs are also allocated to LIEE, CARE, and SBX1 5 programs.

Source: Custom Allocation Rules (Document Response PGE-DP-3.4).

- As described in the background section, in 2001, PG&E changed its treatment of the PCC standard variance. Prior to 2001, the standard variance was distributed by SAP to orders charged by the PCC during a given month. Starting in 2001, the monthly PCC variances were recorded in separate variance orders. The variance order amounts for select energy efficiency-related PCCs are allocated to energy efficiency orders through the Custom Allocation process in Tracker. Only energy efficiency orders that incur labor charges in the given month will receive a portion of this allocation.
- The rules used to allocate the custom allocated amounts vary based on the type of costs, and the programs supported. For example, MPC costs allocated to programs are supported by the MPC based on their relative amounts of labor and incentive dollars, while the Contract support costs are allocated to Energy Efficiency, LIEE and Clean Air Transportation programs based on relative levels of contract costs.

C10. The overhead amounts associated with electric labor were calculated correctly using PG&E’s “third party billing rates.”

- PG&E used “third party billing rates” rates to calculate the corporate overhead associated with its electric labor.
 - ⇒ “Third party billing rates” are rates used by PG&E to bill third parties for non-tariffed services. The rates capture labor-driven costs that are incurred when PG&E provides services, but are not included in the standard cost charged in the SAP system. In other words, the billing rates are used to gross-up the standard cost charged. Examples of costs not included in the standard cost are PBOP (Post-Retirement Benefit Other than Pension) medical and life insurance, workers compensation, long-term disability, property insurance, liability insurance, third party claims, and light-duty payroll.
 - ⇒ Each year, these rates are updated by PG&E’s Management Reporting Department to reflect the previous year’s recorded costs, as well as the budgets for some items.
- PG&E explained its inclusion of electric benefits and payroll taxes and corporate overhead costs in the 1999 CEE Budget proposal:

The proposed electric budgets include PG&E’s estimated labor-driven benefit and payroll tax costs and corporate overheads since these costs are not included in PG&E’s base revenue request in the 1999 GRC for electric DSM [Demand-Side Management] expense. The proposed gas budgets, however, do not include any of PG&E’s labor-driven costs or corporate overheads since these costs are already included in PG&E’s base revenue request in the 1999 GRC for gas DSM expense.

- According to PG&E, the Commission implicitly adopted the use of the Third Party Billing rate to determine corporate overhead rate used therein when the Commission adopted PG&E’s CEE budget proposals in D. 00-07-017. Subsequently, PG&E used the same calculation approach and descriptive text in Application 00-11-037 for its program year 2001. Again, in D. 01-01-060, the Commission adopted PG&E’s 2001 budget proposals.
- **Exhibit V-27** lists the corporate overhead rates applied to electric labor associated with the delivery of energy efficiency programs for Program Year (PY) 1999 – 2002.

Exhibit V-27: Overhead Rates Applied to Energy Efficiency Electric Labor

| Program Year | Third Party Billing Rates | Rates Applied to Electric Labor |
|--------------|---------------------------|---------------------------------|
| 1999 | 40% | 40% |
| 2000 | 41% | 41% |
| 2001 | 52% | 52% |
| 2002 | 83% | 52% |

Source: Overhead Rates (Document Response PGE-EAL-011.1).

- According to PG&E, the 2001 third party billing rate was applied to the labor in the electric PY 2002 programs because the rates generated by the Budget department were not available at the time the proposed PY 2002 energy efficiency programs were submitted to the Commission.
- The corporate overhead rate, established by PG&E's Budget department, is based on actual costs booked from the prior year and some economic factors. blueCONSULTING did not verify the development of this rate in this audit.

C11. Allocated (Clearing) costs include approximately \$255,000 for payroll taxes and benefits, which are also included in base rates. This amount should be excluded from PG&E's energy efficiency program costs.

- A summary of the allocated costs charged to energy efficiency programs during the audit period is shown in **Exhibit V-28**.

**Exhibit V-28: PG&E Energy Efficiency Program Allocated (Clearing) Costs
(Dollars in Thousands)**

| Cost Element | 1998 | 1999 | 2000 | 2001 | 2002 | Five Year Total | Percent |
|--------------------------|----------------|----------------|----------------|----------------|----------------|-----------------|-------------|
| Clearing - Supervision | \$784 | \$1,171 | \$1,477 | \$511 | \$323 | \$4,267 | 23% |
| Clearing - Info Syst | 799 | 640 | 888 | 474 | 336 | 3,137 | 17% |
| Clearing - Facilities | 410 | 265 | 435 | 156 | 309 | 1,574 | 9% |
| Clearing - Supvn. Labor | - | - | - | 860 | 696 | 1,556 | 9% |
| Clearing - Engineering | 265 | 576 | 503 | 99 | 35 | 1,479 | 8% |
| Clearing - Benefits | - | - | 344 | 453 | 358 | 1,155 | 6% |
| Clearing - Info Sys .Lbr | - | - | - | 696 | 458 | 1,154 | 6% |
| Clearing - Engin. Labor | - | - | - | 279 | 335 | 614 | 3% |
| Clearing - Facil. Labor | - | - | - | 283 | 284 | 567 | 3% |
| Clearing - Other | 513 | (0) | 13 | (5) | (2) | 519 | 3% |
| Clearing - P/R Taxes | - | - | 153 | 196 | 157 | 507 | 3% |
| Clearing - Training | 45 | 68 | 193 | 54 | 67 | 428 | 2% |
| Clearing - Stores | 50 | 44 | 174 | 131 | 29 | 428 | 2% |
| Clearing - Off Svcs | 27 | 54 | 64 | 41 | - | 186 | 1% |
| Clearing - Trans & Equip | 43 | 22 | 21 | 20 | 66 | 172 | 1% |
| Clearing - Stores Lbr | - | - | - | 116 | 47 | 163 | 1% |
| Clearing - Training Lbr | - | - | - | 77 | 50 | 126 | 1% |
| Clearing - OffSvcs. Lbr | - | - | - | 84 | - | 84 | 0% |
| Clearing - Trans&Eq Lbr | - | - | - | 22 | 26 | 48 | 0% |
| Total | \$2,940 | \$2,840 | \$4,265 | \$4,548 | \$3,574 | \$18,167 | 100% |

Source: SAP Data Provided in PGE-DP-3.2 Follow-Up; blueCONSULTING Analysis.

- As explained earlier, there are two principal sources of allocated (clearing) costs:
 - ⇒ “Cascading” costs from supervisory cost centers. The PCC costs of the vice presidents and directors of organizations who work on energy efficiency programs “cascade” to the PCCs directly involved in the programs and then are allocated to orders based on the standard rate process. These costs totaled \$5.8 million.
 - ⇒ Costs for chargeback organizations such as engineering or information systems. The greatest chargeback clearing cost is for Information Systems, which charged \$4.3 million to energy efficiency programs during the audit period.
- The clearing costs include \$1.7 million costs for the benefits and payroll taxes. Approximately 15 percent, or \$255,000, of this amount represents the burden associated with gas labor and should be excluded from PG&E’s energy efficiency program costs.
 - ⇒ blueCONSULTING reviewed the 1999 GRC work papers and confirmed that the energy efficiency electric-labor-driven clearing account benefits and payroll taxes were not included in PG&E’s base rates in the period 1999 through 2002.
 - ⇒ As shown in Exhibit V-25, approximately 15 percent of energy efficiency labor costs are gas-program related.

C12. With the exception of the double-counting of gas labor-related payroll taxes and benefit burdens included in allocated (clearing) costs and in PG&E’s base rates (See Conclusion No. C11), there is no double-counting between Overhead Costs, Allocated Costs (Clearing Costs), Payroll Burdens, Custom Allocated Costs, and the Administrative & General Costs included in PG&E’s base rates.

- Electric labor-driven A&G expenses (corporate overhead, payroll taxes, and benefits), which are included in PG&E’s energy efficiency costs, are not included in PG&E’s base rates.
- In the years 2001 and 2002, PG&E included the standard variance for certain Rates and Accounts Services departments as part of its custom allocated costs. The standard variance is not included in other PG&E overhead costs.
 - ⇒ Costs in the variance orders are recorded in Major Work Category “EJ”, which is in regulatory category 9089. The regulatory category translates to FERC account 908. All energy efficiency costs booked to the energy efficiency balancing account are recorded in FERC accounts 908 and 909.
 - ⇒ The direct costs in the variance orders are not booked in the balancing account until they are allocated to energy efficiency orders via the Custom Allocation process.
- Allocated (clearing) costs represent the costs from chargeback and supervisory organizations. With the possible exception of the payroll taxes and benefit burdens included in the clearing costs (See Conclusion No. C11), these costs are not included in PG&E’s base rates.

C13. PG&E's Public Purpose Program Energy Efficiency Balancing Account (PPPEEBA) properly reflects the energy efficiency costs recorded in PG&E's accounting system and the energy efficiency revenue requirements authorized by the Commission.

- blueCONSULTING verified that the PPPEEBA amounts are recorded in accordance with Advice Letter 1729-E.
- The PPPEEBA showed a balance of (\$148.7) million as of December 31, 2002 (spending less than revenue requirement).

Exhibit V-29: PG&E Spent \$148.7 Million less than its Revenue Requirement During the Audit Period
(Dollars in Thousands)

| Program Year | Revenue Requirement | Costs and Interests | Balance |
|-------------------------|---------------------|---------------------|--------------------|
| Electric | | | |
| 1998 | (\$105,899) | \$49,351 | (\$56,548) |
| 1999 | (106,000) | 56,014 | (49,986) |
| 2000 | (106,000) | 131,672 | 25,672 |
| 2001 | (106,000) | 107,616 | 1,616 |
| 2002 | (106,000) | 50,953 | (55,047) |
| Balance | | | (\$134,293) |
| Gas | | | |
| 1998 | (\$12,889) | \$5,756 | (\$7,133) |
| 1999 | (12,888) | 8,871 | (4,017) |
| 2000 | (12,888) | 11,546 | (1,342) |
| 2001 | (12,888) | 15,276 | 2,388 |
| 2002 | (12,888) | 8,601 | (4,287) |
| Balance | | | (\$14,390) |
| Electric and Gas | | | |
| Total balance | | | (\$148,683) |

Source: PPEEBA Work Papers (Received in Interview PGE-JWC-)

3. Recommendations for the Company:

- R1. PG&E should reclassify the costs as shown in Exhibit V-18 and adjust the balancing account as necessary. (Refers to Conclusion No. C6, C7, and C11)**
- R2. PG&E should strengthen its controls to ensure that costs are recorded with the correct cost element in SAP. (Refers to Conclusion No. C1, C3, and C7)**
- R3. PG&E should correct the algorithm in its timesheets so that when an individual works more than 40 hours per week, there is a consistent basis to reduce actual hours charged to each order to reflect a 40 hour week. (Refers to Conclusion No. C3)**

R4. PG&E should review the charges to its energy efficiency programs from non-CEM or Account Services PCCs to identify any erroneous charges, even though the amount is small (less than \$500,000). (Refers to Conclusion No. C6)

R5. PG&E should make the appropriate adjustments to the balancing account to correct the overstatement of electric burdens. (Refers to Conclusion No. C11)

4. Policy Issues for the Commission:

None.

D. SCE

1. Background

SCE's energy efficiency program expenditures totaled almost \$326 million during the 1998-2002 audit period, as shown below.

**Exhibit V-30: SCE Expended \$326 Million through December 31, 2002
on PY 1998-2002 Energy Efficiency Programs
(Dollars in Thousands)**

| | 1998 | 1999 | 2000 | 2001 | 2002 | Total |
|--------------------|-----------------|-----------------|-----------------|-----------------|-----------------|------------------|
| PY 1998 | \$35,571 | \$14,159 | \$4,439 | \$1,736 | \$2,621 | \$58,526 |
| PY 1999 | | 36,664 | 11,191 | 4,773 | 2,882 | 55,510 |
| PY 2000 | | | 44,370 | 14,902 | 4,918 | 64,190 |
| Summer Initiative | | | 3,316 | 13,094 | 5,531 | 21,941 |
| PY 2001 | | | | 57,321 | 18,102 | 75,423 |
| PY 2002 (3 months) | | | | | 6,591 | 6,591 |
| PY 2002 (9 months) | | | | | 43,753 | 43,753 |
| Total | \$35,571 | \$50,823 | \$63,316 | \$91,826 | \$84,398 | \$325,934 |

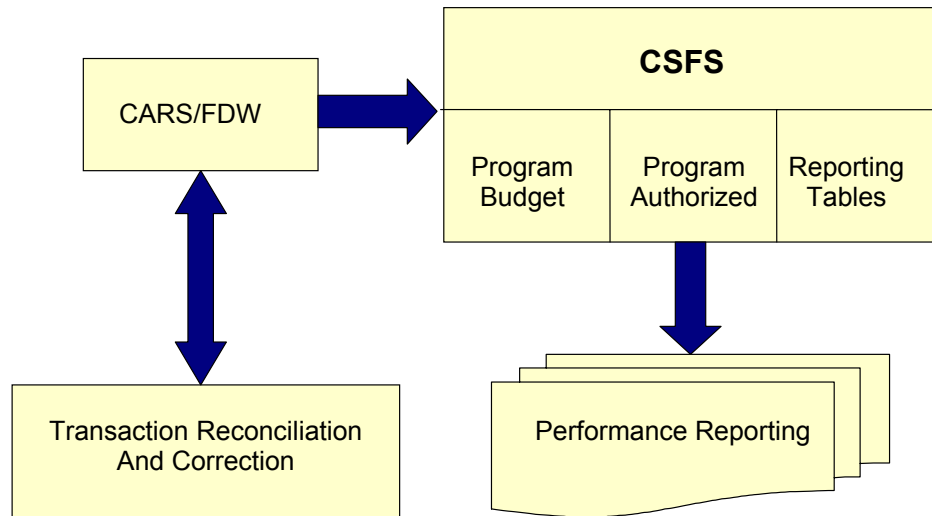
Source: Data Response SCE-17.

Additional detail of SCE's expenditures is provided in **Schedule A** at the end of this section.

Energy Efficiency Accounting

SCE uses its Corporate Accounting and Reporting System (CARS) to account for energy efficiency program expenditures. All financial transactions are recorded through CARS. The Financial Data Warehouse (FDW) and the Customer Service Financial System (CSFS) are sources for Public Goods Charge (PGC) reporting. **Exhibit V-31** provides an overview of the financial system. Most PGC accounting transactions are entered in CARS from the Payroll System and the Accounts Payable System. Customer Service Business Unit (CSBU) procurement and payment guidelines are followed by all personnel who submit and approve requests. Every pay period, each manager or supervisor is responsible for reviewing and approving each subordinate's time sheet and employee expense reports.

Exhibit V-31: Financial Systems Overview – Energy Efficiency Expenditures are Tracked within SCE’s Corporate Accounting System



Source: SCE Presentation, August 21, 2003.

PGC expenditures are uniquely identified by the expense category, trial balance account (TBA) and Prime/Sub. All PGC expenditures are recorded in trial balance accounts 907.000, 908.000, 905.975, and 909.000. The TBA is a Summary Account based on the FERC list of accounts. These four trial balances are summarized in Expense Category 210 00. The combination of the Location and Function is what is referred to in CARS as a “budget item.” Each budget item maps to a trial balance account. Every PGC expenditure is identified by a budget item that maps to one of the trial balance accounts mentioned above. Every PGC expenditure must also have a Prime/Sub that identifies the specific PGC program for which the expenditure was recorded. Energy efficiency expenses are also recorded in the Energy Efficiency Program Adjustment Mechanism (EEPAM) balancing account. Accounting code components are described in **Exhibit V-32**, which follows.

Exhibit V-32: SCE’s Accounting System Is Organized By Components: Location, Function, Prime/Sub, Area of Responsibility and Cost Elements

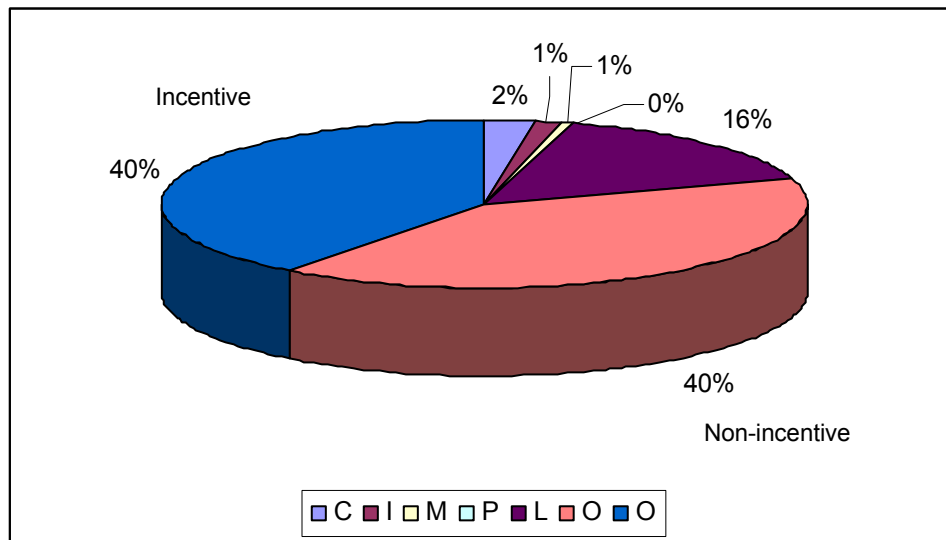
| Component | Description |
|------------------------------|---|
| Location | Identifies the organization responsible for the transaction. Used to group information by Manager. Also used to distinguish between energy efficiency and O&M expenses. |
| Function | Specifies the activity. Functions are established based on reporting requirements to segregate certain costs for tracking and reporting purposes. Used to group similar types of activities for reporting purposes. Incentives are Function 4232 or 4231. |
| Prime/Sub | A project number that identifies the specific PGC program or other classification of costs such as MA&E. Enables activities to be separated by program year. Each program year has a new and unique set of prime/sub numbers. |
| Area of Responsibility (AOR) | Used to provide a management hierarchy to reports. |
| Source Code | Identifies the specific type of transaction. Source codes distinguish between a direct labor charge and a labor adder. |
| Trial Balance Account | A Summary of Account based on the FERC Uniform System of Accounts. |

| Component | Description |
|--------------|---|
| Cost Element | <p>Identifies the type of cost:</p> <p>Labor (L): SCE labor charges include straight time, bonuses, and corporate adders (accruals, overtime, vacation).</p> <p>Materials (M): Items purchased through SCE material and supply.</p> <p>Contract (C): Agency temporary employee labor charges.</p> <p>Other (O): All other items, including consultants, incentives, expense reports, travel. The majority of the PGC costs are classified as Other.</p> <p>IMM (I): Charges from service providers within SCE (Chargebacks/Allocated).</p> <p>Payroll Loadings (P): Charged to O&M general rates, not energy efficiency programs.</p> <p>Supply Expense (S).</p> <p>Division Overhead (D).</p> <p>Each of the cost elements used for PGC programs is described further below.</p> |

Source: SCE Data Responses 18 and 20.

Not all cost elements are used for the PGC programs. SCE does not charge supply expense, division overheads, or payroll loading to the PGC programs. As shown below, the majority of SCE's costs are categorized as cost element O (Other). Cost element O includes contractor and vendor costs as well as incentive payments, which are identified by specific function codes.

Exhibit V-33: 80 Percent of SCE's \$326 Million in Energy Efficiency Expenditures Were Classified as "Other" Charges



| Code | Name | Description | Amount (\$000) |
|------|---------------------------------|-----------------------------|------------------|
| C | Contract | Temporary Labor | \$7,750 |
| I | Internal Market Mechanism (IMM) | Allocated Services | 4,800 |
| M | Material | Materials | 1,531 |
| P | Payroll loadings | Benefits & P/R Taxes | 1 |
| L | Labor | Employee payroll | 51,114 |
| O | Other | Other expenses | 130,824 |
| | | Total Administrative | \$196,020 |
| O | Other | Incentives | 129,915 |
| | | Total Expenditures | \$325,935 |

Source: blueCONSULTING Queries, Accounting Transaction Detail Database (SCE Data Response 77).

Contract (Cost Element C)

SCE assigns its temporary agency labor costs to cost element C. Temporary labor is used in a variety of programs, as well as incentive processing. Contract employees utilize time sheets which indicate the various programs they worked on and the hours worked by program. Time sheets are signed by the appropriate manager on a weekly basis. The Cost element C also includes expenditures associated with individuals working as temporary labor consultants for applications development. Consultants and other contractors are not charged to Cost Element C.

Internal Market Mechanism (Cost Element I)

The Internal Market Mechanism (IMM) cost element is primarily comprised of charges for services provided by departments within SCE. The IMM process is the mechanism SCE uses to provide visibility and accountability to organizations receiving corporate services. Only costs that are directly attributable to PGC energy efficiency programs can be charged to a PGC energy efficiency account. Examples include automobiles that support the pump test programs, computers and desktop support for employees that are dedicated to PGC energy efficiency activities, and requests for specialized printing projects such as brochures and mailers. These expenditures are generated when the program managers request services from information technology (IT), graphics, vehicle usage etc. Rates for IMM expenditures are set at the beginning of each year.

With the exception of monthly IT charges for the desktop computers, IMM charges are initiated by the program manager. The monthly IMM rate for Desktops was charged to various PGC programs starting in 2000. The IT department also charges the specific PGC program for services based on the type and level of individual needed to accomplish the requested services.

The program manager works with SCE's Business Resource Organization to provide printing and graphic services to the program. The graphic production expenses are based on specific project and not standard rates.

The transportation expenses are charged based on requested services. The program manager requests an automobile be given to all pump testing employees and the transportation department arranges for the vehicles and charges the requesting program. If the request was to provide an employee a car for one week for a specific project, the transportation department would arrange for the car, probably from a pool of available cars specifically for SCE business use and charge the project for the cost of that specific car for that period of time.

Materials (Cost Element M)

The material expenditure element for administrative expenditures is primarily comprised of materials (supplies) purchased. The majority of the expenditures charged to this cost element are for materials and supplies purchased to be used by the project and its employees. The project manager will prepare a purchase order for supplies needed for the project.

Labor (Cost Element L)

The Labor expense cost element is primarily comprised of employee payroll expense (excluding benefits and taxes) for work done on or for energy efficiency programs. Some employees are dedicated to a certain program, while others work on multiple energy efficiency programs or a combination of energy efficiency and non-energy efficiency activities. Results Sharing and MIP (Management Incentive Program) compensation is not charged to energy efficiency programs.

Expenditures related to labor are recorded in two ways depending on type of employee (hourly versus salary). Hourly employees designate on their timesheets which projects (and corresponding accounting codes) they worked on during that pay period, and those projects are charged accordingly. Hourly employees who are dedicated to a project use the same accounting code for each pay period.

SCE uses a fixed labor distribution for its salaried employees. Labor distributions (allocations to various programs) are established at the beginning of each year, based on expectations of the type of work to be performed by each employee, and are used to charge an individual's time to various programs for the entire year. If the employee is dedicated, all of the employee's time is dedicated to that project (prime/sub). If the employee is working on various projects, their labor distribution is allocated accordingly. Programs are then charged time in each pay period based on the established fixed distribution. During each pay period, a time sheet is submitted that includes hours for absences and any change in the fixed distribution due to temporary changes in program assignment. Should the employee transfer to another program or function, the labor distribution is changed to reflect the change in job duties and/or programs. These allocations are reassessed when personnel changes occur throughout the year.

At the beginning of each year a factor (percentage) is determined which is used to charge the programs for vacation, sick time, paid time off, etc. This amount is evaluated at year end, and adjustments made to the charges if deemed necessary.

Payroll Loadings (P)

This cost element includes charges for employee benefits (source code 026) and payroll taxes (source code 027). SCE does not charge employee benefits or payroll taxes to energy efficiency programs, but it includes these charges in distribution rates.

Other (Cost Element O)

The Other expense cost element is primarily comprised of all expenses that do not fall into any other cost element category. The top three function numbers (excluding the incentive function numbers) for the O cost element are Special Program Activities (\$47.9 million), Consultants (\$37.9 million) and Miscellaneous Costs (\$23.3 million), which make up 83 percent of total administrative other expenses. A large majority of these expenses are processed through the accounts payable system and are approved by the project managers and/or senior management, with most of them being processed against purchase orders.

The Other expense cost element is also used for incentive expenditures. The difference is the coding of the function codes. Incentives are assigned function code 4231 or 4232. An incentive is a form of financial assistance provided to an entity for the installation of an energy efficiency product or products at an identified customer site. Most energy efficiency programs have pre-established rebate amounts, with some programs determining the rebate amount by the energy savings generated.

Accounting Controls

SCE personnel responsible for submitting payment requests determine the type of activity based on the invoice. The appropriate accounting is obtained from the CSBU Finance Client Analyst either verbally or from written documents. The CSBU Finance Client Analysts determine the appropriate function for labor transactions based on the activities performed. The CSBU Finance Internal Market Mechanism (IMM) project manager provides appropriate accounting to each IMM Service Provider for each product or service provided to CSBU. Cost elements are determined by the source document submitted for payment. For example:

- A processed electronic time sheet is automatically assigned cost element L.
- Transactions initiated by the IMM billing system are assigned to cost element I.
- An invoice submitted and paid via the Accounts Payable System will be assigned to the cost element O.
- Invoices paid to personnel agencies will be processed using the cost element C.

Exhibit V-34 provides an overview of the controls over accounting transaction inputs.

Exhibit V-34: SCE Has Established Controls for Each of its Major Accounting Systems

| Accounting Input System | Controls |
|-------------------------|---|
| Payroll | <ul style="list-style-type: none"> ▪ The combination of location/function and unique prime and sub accounts records the PGC energy efficiency-related labor to a specific PGC energy efficiency program. ▪ Each employee's timesheet is approved in the online timekeeping system by his manager or supervisor to validate the time worked. |
| Materials Management | <ul style="list-style-type: none"> ▪ The authorization to purchase office supplies using this online system is granted in accordance with the CSBU Approval Matrix by each supervisor or manager. ▪ At the time of ordering the accounting must be provided by the requestor. |

| Accounting Input System | Controls |
|--------------------------------|--|
| Accounts Payable | <ul style="list-style-type: none"> ▪ Vendor invoices are paid by this system. Once an invoice is approved by the responsible organization, the invoice and all of the approval documentation is forwarded to Accounts Payable for payment. The approval process for submitting invoices for processing is as follows: <ul style="list-style-type: none"> ⇒ The program manager or designee reviews the invoice and supporting documentation to ensure that expenditures are valid and the work being invoiced was performed in accordance with the appropriate purchase order or contract. ⇒ The program manager assigns the accounting on the invoice and submits the invoice and supporting documentation to the invoice processing group in CSBU Administration. ⇒ CSBU Administration reviews the package to ensure the documentation is complete and the accounting has been provided, and then routes the package for approval in accordance with the CSBU Approval Matrix. |
| Field Payment | <ul style="list-style-type: none"> ▪ The Field Payment System is used for approval of employee expense reimbursement. ▪ All employee expenses are submitted on the Employee Expense Reimbursement Form and must be reviewed and approved in writing by the employee's supervisor or manager. ▪ Accounting and supporting documentation must accompany each expense line item. |
| Procurement Cards | <ul style="list-style-type: none"> ▪ Procurement of small items can be done using a Procurement Credit Card. ▪ This type of card has very limited use within CSBU. ▪ The specific controls for use of this type of card are provided for in the CSBU Procurement Card Guidelines. |
| IMM | <ul style="list-style-type: none"> ▪ Only costs that are directly attributable to energy efficiency programs can be charged to an energy efficiency account. ▪ In the case of automobiles, a service agreement is approved in writing by the responsible Pump Test program manager during the annual planning process that specifies the number and types of vehicles required for PGC energy efficiency-related activities for the year and to which programs they are to be charged. ▪ Energy efficiency related computer and desktop support is charged on a per person basis. The IMM annual planning process specifies the proper accounting for the year. ▪ When specific PGC-related printing requests are made throughout the course of the year, the program prime/sub must be on a request form. The program manager must authorize the printing requests by reviewing and signing the request forms. |
| Error Correction/Voucher Entry | <ul style="list-style-type: none"> ▪ This system is used to make corrections to detail transactions. ▪ Only CSBU Finance personnel are authorized to make changes to the CARS accounting detail transactions. ▪ All changes require the written approval of a program manager. |

Source: SCE Data Response 25.

Once all costs for the month are recorded in CARS, the detail transactions are transferred to CSFS for reporting purposes. This transfer is necessary in order to provide budget to recorded comparison reports. The function/location in combination with prime/sub accounts are used to track the costs of each program. CARS does not have the capability to budget by prime/sub. Budgeting occurs in CSFS. In order to ensure all transactions are correctly reflected in CSFS, a validation is done by the CSBU Finance Systems Client Analyst to reconcile the total of the trial balance accounts.

Once the detail transactions are moved to CSFS, the Finance Client Analysts provide the detailed transactions to each program manager on a monthly basis for review. The program manager or designee reviews the detailed transactions to verify charges are valid. The review includes validating labor charges (by name), vendor charges, and internal service providers (e.g. printing, mailing services, automobiles, etc). If erroneous transactions are found, the program manager communicates with the Finance Client Analysts to process corrections. The Finance Client Analysts also review detail and summary reports to identify potentially erroneous charges. If errors are found, the Finance Client Analyst contacts the program manager to determine whether or not a correction is required. The current process is documented using a form that requires acknowledgment by each of the program managers, or their designee before any transactions can be changed.

2. Summary of Adjustments

Exhibit V-35 provides a summary of adjustments to the December 31, 2002 EEPAM balance identified by our audit. Although not material, SCE intends to correct all confirmed accounting errors identified by our audit. Therefore, the adjustments are presented below. The majority of the adjustments result from errors in the allocation of costs between energy efficiency programs and operations and maintenance (O&M) functions, and incorrect inclusion of costs embedded in base rates.

Exhibit V-35: SCE Plans to Adjust the Balancing Account by \$195,000

| Cost Element | Amount | Reason |
|--|------------------|--|
| Direct Costs | | |
| C | \$0 | |
| M | 13,767 | Incorrect application of sales tax to labor, O&M charges. |
| P | 1,127 | Payroll taxes and loadings should not have been charged to programs. |
| L | 0 | |
| O (non-incentive) | 42,863 | O&M costs, pre-1998 expenditures. |
| O (incentive) | 218 | Errors in determination of SCE's proportion of costs for joint-IOU programs. |
| Indirect Costs and Inter-Departmental Charges | | |
| I | 136,534 | Categories of costs included in base rates. |
| Total | \$194,509 | |

Source: Results of blueCONSULTING's Transaction Testing.

3. Conclusions

C14. In general, SCE's direct energy efficiency costs are properly supported and classified. Minor exceptions were noted and are discussed later in this chapter; however, no material adjustments were identified. Identified adjustments are only presented below because SCE intends to correct the accounting.

- Within the audit time frame, SCE was able to provide support for almost all of the transactions selected for testing. Instances where support was not provided within the audit time frame are noted below. Missing support does not imply the charges are inappropriate. In some cases vendor invoices may have been provided, but receipts for

vendor expenses may not have been provided. With additional time, missing support may have been provided.

- Misclassified charges identified below may have been contemporaneously identified and corrected by SCE. The audit time table did not allow for this investigation in all cases.
- In general, we did not receive cancelled checks. In some, but not all cases, screen prints from the Accounts Payable systems were provided, demonstrating that payment had been made.

Cost Element C Adjustments

- No adjustments to costs charged to cost element C were identified. Minor exceptions are noted in **Exhibit V-36**.

Exhibit V-36: No Adjustments to Cost Element C Costs

| Exception | Amount | Number of Transactions | Percent of Sample |
|---|------------|------------------------|-------------------|
| Cost adjustment | | | |
| Total balancing account adjustments | \$0 | | |
| Accounting errors – no cost adjustment | | | |
| Incorrect program accounting – program or program year (Transfer within energy efficiency programs, no net effect on balancing account) | | 1 | 4% |
| Total exceptions | | 1 | 4% |
| All transactions sampled | | 27 | |
| Cost Classification Errors | | | |
| Misclassified cost element code (incentives classified as contract) | | 2 | |
| Lack of evidence of compliance with review and approval process | | | |
| Necessary approvals and authorizations not documented | | 1 | |

Source: blueCONSULTING transaction testing (Data Response 102 and 102 Supplements).

Cost Element M Adjustments

- Cost element M comprises less than one percent of SCE total energy efficiency expenditures from 1998 through 2002. As shown in **Exhibit V-37** (page following), \$13,767 in adjustments were identified.
- ⇒ Two of the samples selected were materials purchases that included labor charges. In both instances, SCE charged sales tax on the labor portion. A large majority of SCE's materials purchases do not include sales tax. Sales tax is added to the purchase price by SCE. SCE is the end user of the item so it is appropriate to add sales tax to the purchase price and remit the sales tax to the state; however, the sales tax should not be applied to the labor costs in these sample items.

⇒ Expenses associated with CTAC and AgTAC should have been charged to O&M, but were charged to energy efficiency programs.

Exhibit V-37: \$13,767 of Adjustments to Cost Element M

| Exception | Amount | Number of Transactions | Percent of Sample |
|---|-----------------|------------------------|-------------------|
| Cost adjustment | | | |
| Incorrect sales tax or sales tax charged on labor | \$9,118 | 4 | 13% |
| Not energy efficiency | 4,649 | 5 | 16% |
| Total balancing account adjustments | \$13,767 | 9 | |
| Accounting errors – no cost adjustment | | | |
| Incorrect program accounting – program or program year (Transfer within energy efficiency programs, no net effect on balancing account) | | 1 | 3% |
| Total Exceptions | | 10 | 32% |
| All transactions sampled | | 31 | |
| Accounting errors – no cost adjustment | | | |
| Misclassified cost element code (consulting services (cost element O) classified as materials) | | 1 | 3% |
| Lack of evidence of compliance with review and approval process | | | |
| Necessary approvals and authorizations not documented | | 6 | 19% |
| Inadequate supporting documentation | | | |
| Small transactions, no supporting documentation provided | | 2 | |
| Procurement card violations | | 1 | |

Source: blueCONSULTING transaction testing (Data Response 112 and 112 Supplements).

Cost Element L Adjustment

- blueCONSULTING identified no adjustments to Cost Element L costs. Labor costs are charged to the programs based on the employee's labor rate and fixed distribution, and they are charged on a calendar year basis. Fixed labor distributions were consistent with descriptions of the work performed by the employees.
- ⇒ Labor expenditures are charged to current year program expenses and not to prior years, even if the programs are multi-year programs. The annual update of fixed distributions does not always take effect by the first pay period of the year, resulting in prior year programs being charged in the following year. Correcting journal entries are only prepared for some of the late changes in fixed labor distribution.
- ⇒ Our testing confirmed that fixed labor distributions were adjusted throughout the year due to changes in job functions or duties.
- ⇒ Bonuses and payroll taxes and loadings were not charged to the programs.

⇒ It is not possible to definitely verify the assignment of labor hours based on fixed distribution because there is no record of what employees actually did (e.g., employees were not required to submit time cards). SCE provided descriptions of the worked performed for the selected employee labor transactions. These descriptions were used to confirm the appropriateness of the charges.

- **Schedule B** at the end of this section lists energy efficiency employees with labor charges in excess of \$1,000.

Cost Element O Adjustments

- As shown in **Exhibit V-38**, blueCONSULTING's analysis identified \$42,863 in balancing account adjustments resulting from incorrect charges to cost element O. Adjustments result from timing issues (costs incurred in 1997 which were paid in 1998 and charged to PY 1998 programs) and errors in the allocation of costs between energy efficiency programs and O&M.

Exhibit V-38: \$43,081 of Adjustments to Cost Element O [Note 1]

| Exception | Amount | Number of Transactions | Percent of Sample |
|---|-----------------|------------------------|-------------------|
| Cost adjustment | | | |
| Not energy efficiency (should have been charged to O&M) | \$31,557 | 9 | 3% |
| Pre-1998 expenditures | 6,833 | 6 | 2% |
| Misclassified payments to Edison O&M (not identified through sample testing) | 3,000 | NA | |
| Edison Electric Institute cost should have been split with O&M (not identified through sample testing) | 1473 | NA | |
| Subtotal | \$42,863 | | |
| Incentive cost allocation errors | \$218 | | |
| Total Adjustments | \$43,081 | | |
| Accounting errors – no cost adjustment | | | |
| Incorrect program accounting – program or program year (Transfer within energy efficiency programs, no net effect on balancing account) | | 12 | 4% |
| Total Exceptions | | 27 | 8% |
| All Transactions Sampled | | 341 [Note 1] | |
| Cost Classification errors – no cost adjustment | | | |
| Misclassified function code (Transfers within a year, no net effect on balancing account or program year) | | 13 [Note 2] | |
| Lack of evidence of compliance with internal review and approval process | | | |
| Necessary approvals and authorizations not documented | | 9 [Note 2] | |

| Exception | Amount | Number of Transactions | Percent of Sample |
|---|--------|------------------------|-------------------|
| Inadequate supporting documentation provided within audit time frame | | | |
| Inconsistent with terms of the purchase order, incomplete support (per PO, invoice to include supporting docs which were not provided; labor rates not match PO, no support for rate paid to contractor, missing COs) | | 20 | |
| No support for transaction provided | | 1 | |

Note 1: Does not include nine Grey advertising samples discussed below.

Note 2: One of the files also missing authorization, shown in two categories, only included once in total count.

Source: blueCONSULTING Transaction testing (Data Response 116).

- With the exception of errors in the allocation of costs to SCE and SCG for the Residential SPC program, blueCONSULTING identified no adjustments to SCE's incentive costs. Errors in the allocation of costs had a net effect of \$218.

Cost Element P Adjustments

- SCE does not charge payroll taxes and loadings to its programs. \$1,127 was inadvertently charged to the programs and should be adjusted.

Other Exceptions

- Other exceptions include:
 - ⇒ Missing approvals or payment authorizations.
 - ⇒ Contractor labor rates or unit rates which were not consistent with the terms of the purchase order.
 - ⇒ Incorrect accounting codes. Incorrect cost element charges have no effect on the balancing account, and generally have no effect on the information reported to the Commission. The cost element for a transaction is determined by the source code based on the payment type, and an adjustment cannot be made to change the cost element. Charges to the wrong function code and program code may affect the information reported to the Commission or the program year against which expenditures are reported.
 - ⇒ Timing errors associated with advance payments as discussed in Conclusion No. C15.

C15. Controls over the use of Grey Advertising (a corporate advertising contract) are insufficient to ensure energy efficiency costs are appropriately accounted for.

- SCE has a blanket PO with Grey Advertising for the provision of advertising and marketing services. Individual departments and programs may use Grey's services under this PO. During the audit period, Grey's services were used by 32 programs (not including Grey Worldwide's Flex-Your-Power contract) and totaled **(amount redacted for reasons of confidentiality)** as shown below. An additional **(amount redacted for reasons of confidentiality)** was paid to Grey Worldwide for the Flex-Your-Power advertising campaign in 2001 and 2002.

Exhibit V-39: Confidential Exhibit - Redacted

- blueCONSULTING's sample of vendor payments selected for transaction testing included nine payments to Grey Advertising. The following exceptions were noted.
 - ⇒ SCE prepays for advertising. As a result, advertising may be paid for in one program year, when the ads are actually run for a subsequent program year program. Although this has no net balancing account effect, it does affect the program year budget against which expenditures are charged. As shown in **Exhibit V-40**, this occurred in four of the nine transactions tested.
 - ⇒ No contemporaneous documentation was provided evidencing pre-approvals.
 - ⇒ No reconciliations were provided which would allow us to confirm that the advertising spots paid for were actually performed.

Exhibit V-40: Confidential Exhibit - Redacted

- **Discussion of Internal Audit findings redacted for reasons of confidentiality.**

C16. Cost controls are inadequate to ensure purchase order limits are not exceeded in a given year. When a program is extended for a new program year, SCE issues a change order to increase an existing PO amount, instead of issuing a new PO. Significant increases are also authorized within a program year. This practice does not allow for adequate monitoring of expenditures. For example:

- **Examples redacted for reasons of confidentiality.**

C17. During the audit period, SCE's corporate guidelines for the proper use of procurement cards were violated.

- Procurement card costs are charged to Cost Element M. These cards are requested and provided to employees who have a need to purchase low risk materials that cost \$2,500 or less and are within the procurement card purchasing guidelines. Credit limits generally do not exceed \$15,000. All credit card holders are responsible for submitting the Procurement Card Purchase Authorization Form along with the actual receipts to the responsible supervisor/manager who approves the expenditure and forwards the package

to CSBU administration for review of documentation and compliance with policy. Any policy violations found are reported to the appropriate supervisor/manager, with the credit card privileges subject to termination.

- CSBU’s policy adheres to SCE’s corporate policy, which states: “[t]he procurement card are restricted to a few individuals, primarily within field locations, who use the cards primarily for emergency supply items and employee recognition.”
- In addition to the corporate policy, CSBU has issued guidelines which include the following:
 - ⇒ “Do NOT split purchases between two cards (i.e., a \$4,000.00 purchase charging \$2,000.00 to 2 cards...This is UNACCEPTABLE)”
 - ⇒ Cards are not to be used to purchase travel and entertainment expenses, dues, donations and membership fees, and cell phone bills.
- blueCONSULTING’s review of procurement card transactions identified the following types of violations of CSBU and Corporate policy.
 - ⇒ Procurement card purchases were split to avoid the \$2,500 limit.
 - ⇒ Procurement cards were used for non-emergency items. Examples based on our sample selection include:
 - Computer and other equipment and materials.
 - Office supplies, newspapers, water, and training materials.
 - Conference registration and demonstration show space.
 - Deposits on larger purchases.

C18. Controls over charges to CTAC and AgTAC should be improved in light of the dual-funded nature of these programs.

- SCE has two facilities that are used for general business and energy efficiency activities. The facilities are used to showcase energy efficiency activities and functions for residential (CTAC) and agricultural (AgTAC) purposes. PGC costs associated with CTAC and AgTAC were about \$12 million over the five year audit period.
 - ⇒ Energy efficiency funds cover the cost of energy efficiency-related seminars, equipment displays, and technical services (e.g., consultations and equipment demonstrations).
 - ⇒ Operations and Maintenance (O&M) funds cover the costs that are not related to energy efficiency programs, including the costs of holding company and employee events that are not related to energy efficiency.

- Costs incurred by CTAC and AgTAC are divided between energy efficiency programs and O&M (Operation and Maintenance) activities based on budget allocations and “management discretion.”

⇒ Activity costs are determined as part of SCE’s program planning process. These costs are later allocated through the budget process. Management assesses the appropriate amount and type of activities needed to support energy efficiency and O&M work by reviewing requirements for the past year and planned work for the upcoming year. The allocation is then determined based on management’s judgment. SCE does not have any written documentation describing how allocations for the energy centers are determined. The composite recorded allocations for CTAC and AgTAC for 1998 through 2002 are shown in **Exhibit V-41** below.

Exhibit V-41: CTAC and AgTAC Costs Are Allocated to PGC and O&M in the Budget Process

| Year | Recorded | |
|------|----------|-----|
| | PGC | O&M |
| 1998 | 58% | 42% |
| 1999 | 47% | 53% |
| 2000 | 55% | 45% |
| 2001 | 61% | 39% |
| 2002 | 55% | 45% |

Source: SCE Data Response 171.

- ⇒ The costs of activities that are not included in the advance planning process are directly charged to PGC or O&M based on management judgment.
- Costs for specific nonrecurring activities (e.g. seminars, displays/exhibits, brochures) are charged based on the subject matter. If a seminar or exhibit is about energy efficiency, the costs are charged to PGC. If the subject is not energy efficiency-related, the costs are charged to O&M. However, if an activity covers both energy efficiency and O&M, the appropriate split is made based on the judgment of the responsible program manager.
 - Administrative expenses, such as office supplies and maintenance, are generally split in accordance to the percentage of energy efficiency and O&M funding received in a given year.
- Despite these budget allocations, blueCONSULTING’s testing found considerable variability in the proportions charged. The majority of the expenditures we tested did not use the stated allocation percentages established at the beginning of each year.
- ⇒ Many methods were used which appear to be appropriate methods of allocation. These include the use of the pre-established labor distribution, number of participants in a program, and the percentage of energy efficiency items on the agenda or training sessions.
- ⇒ The use of pre-established energy efficiency and non-energy efficiency allocations for activities which are 100 percent either energy efficiency or O&M is not appropriate.

- Instances where non-energy efficiency costs were charged to energy efficiency programs were generally associated with CTAC and AgTAC. Cost adjustments identified in **Exhibit V-37** and **Exhibit V-38** which were classified as “not energy efficiency” are generally the result of errors in the allocation of or accounting for costs between PGC programs and O&M at CTAC and AgTAC.

C19. SCE employed two different methods of accounting for expenses and revenues associated with joint-utilities programs.

- During the period under review, SCE administered several energy efficiency programs on behalf of other utilities.
- SCE used two methods of accounting for these activities.
 - ⇒ The first method involved SCE recording only its portion of the cost as an expenditure, and the portion which related to the other utility was recorded as a receivable. This method was used through 2001.
 - ⇒ Beginning in 2002, SCE began recording payments made on behalf of the other utilities as expenditures in the year paid and making a transfer to the receivables account when the expenditure was billed to the other utilities, usually in the next year. This second method appears to inflate the expenditures in one year and significantly reduces the expenditure in the following year. The transaction noted in our testing indicated that approximately \$2.7 million was expensed in 2002, but it will become a credit in 2003.

C20. SCE charged only three types of overhead costs to the energy efficiency programs during the audit period: IMM costs, costs associated with one leased facility, and general administrative support costs which were treated as indirect costs beginning in 2002. Approximately \$137,000 of the IMM costs were for categories of costs which were included in base rates, and should be adjusted.

- Of the total \$325.9 million in expenditures, \$7.4 million (2 percent) is considered allocated overheads. There are no supporting studies on allocation factors used to allocate categories of administrative or overhead costs to the energy efficiency programs. A description of each category and the allocation methodology is provided in **Exhibit V-42**.

**Exhibit V-42: Indirect and Overhead Costs Total \$7.4 Million
(Dollars in Thousands)**

| Cost Category | Period Costs Charged | Amount | Description |
|--------------------------------------|----------------------|----------------|--|
| IMM Costs | 1998-2002 | \$4,981 | Includes IMM costs classified in Cost Element I, and other IMM costs, not classified in Cost Element I |
| San Dimas Building | 1998-2000 | 307 | Lease and supply costs. San Dimas is a leased facility that houses both energy efficiency and other personnel. Each month a building occupancy report was updated and used to determine the allocated proportion based on labor accounting. |
| General Administrative Support Costs | 2002 | 2,119 | Tested as part of direct costs. Prior to 2002, these costs were charged directly to designated prime/subs and not allocated. Beginning in 2002 they were allocated to each program at the request of the Commission based on the dollars approved for each program as a percentage of the total dollars approved for all programs. |
| Total | | \$7,407 | |

Source: SCE Data Responses 19 and 53.

- SCE incorrectly charged \$137,000 (out of \$4.8 million in IMM costs classified in cost element I) to the PGC programs, associated with categories of costs which were included in base rates. The appropriate correction will be made to the balancing account. **Exhibit V-43** provides details of the adjustment.

**Exhibit V-43: IMM Cost Adjustment Is Approximately \$137,000
(Dollars in Thousands)**

| Service Provider | Description | Amount | Adjustment |
|------------------------|---------------------------------|---------|------------|
| None Provided | Graphics Production | \$2,008 | |
| | Vehicle Costs | 745 | |
| | None Provided/Transfer Vouchers | 692 | (96) |
| | Client Requests | 224 | |
| | Geographic Info Maps | 22 | |
| | Standards Lab Services | 22 | |
| | Meter Field Services | 6 | |
| | Job Orders | 5 | |
| | Electrical Field Services | 2 | |
| | Electronic Engineering Services | 2 | |
| Business Resources/MCD | Custom Event Services | 22 | 22 |
| Human Resources | Intact Team Training | 24 | 24 |
| | Employee Catalog Training | 2 | 2 |
| IT CIO | Cell Phone Services | 18 | |
| | GIAS Services | 7 | |
| | Internet Access | 2 | 2 |

| Service Provider | Description | Amount | Adjustment |
|-------------------------|----------------------------------|----------------|--------------|
| Info Technology | IT application Services | 637 | |
| | Desktop Services | 144 | 144 |
| | Online Ordering | 56 | |
| | Desktop Moves/Add/Change | 31 | |
| | Laptop Services | 30 | 30 |
| | Telephone Toll & Long Distance | 27 | |
| | Desktop/Laptop Repair | 18 | |
| | Telephone Moves/Add/Changes | 18 | |
| | Radio Communication | 10 | 10 |
| | 800 Dial-Up Network Access | 8 | |
| | Pager Service | 4 | |
| | Telephone Services | 3 | 3 |
| | Local Dial-Up Network Access | 1 | |
| | Remote Network Access | 1 | |
| Procurement | Special Transport Services | 5 | |
| | Material Transportation Services | 1 | |
| Transportation Services | Aircraft Operations | 3 | |
| Total | | \$4,800 | \$137 |

Source: blueCONSULTING Analysis; Transaction Detail Database (SCE Data Response 72); SCE Data Response 172.

- With the exception of Graphic Production expenditures (\$1.7 million in total), we were unable to test the IMM transactions or verify the allocation methods since SCE could not provide supporting documentation for any IMM expenditures.
 - ⇒ SCE has indicated it did not retain any supporting documentation for IMM charges prior to 2001, but the Company has also been unable to provide the supporting documentation for charges occurring in 2001 and 2002. The unsupported expenditures total approximately \$3.1 million, a portion of which will be adjusted as discussed above.
 - ⇒ The allocation methodologies for the various services appear to be appropriate methods, and the expenditures represent only one percent of SCE's energy efficiency expenditures.
 - The cost for vehicles is based on the lease or purchase price of the vehicles and the maintenance costs for each vehicle. As a result, monthly costs may vary.
 - There is no standard rate for graphics and printing services. Charges are based on the actual cost of the user request.
 - The monthly IMM rate for desktop rates for years 2000 through 2002 are \$118.97, \$117.62 and \$153.90, respectively.

C21. Differences between accounting costs and expenditures recorded in the energy efficiency balancing account, EEPAM, result from shareholder incentive costs and adjustments that could not be verified within the audit time frame.

- Energy efficiency expenses are recorded in the EEPAM. The EEPAM was established to track the difference between 1) authorized Energy Efficiency revenue requirements (e.g., \$90 million) recovered through operation of the TRA and SRBA; and 2) actual incurred energy efficiency program expenses.
- The monthly balance is calculated as follows: the authorized revenue less recorded energy efficiency expenses equals the balance in EEPAM (i.e., over- or undercollection). The over or under collection is carried over from month-to-month.
- As shown in **Exhibit V-44**, \$328.5 million of expenses were recorded in the EEPAM from 1998 through 2002.

Exhibit V-44: \$328.5 Million Was Recorded in Balancing Account from 1998-2002
(Dollars in Thousands)

| Year | Accounting (incl. Post-Closing Adjustments) | Balancing Account | Difference |
|--------------|---|-------------------|------------------|
| 1998 | \$35,573 | 35,563 | \$10 |
| 1999 | 50,825 | 50,805 | 20 |
| 2000 | 63,369 | 71,915 | (8,546) |
| 2001 | 91,828 | 86,229 | 5,599 |
| 2002 | 84,401 | 84,036 | 365 |
| Total | \$325,996 | \$328,548 | (\$2,552) |

Source: Transaction Detail Database and Post Closing Adjustments (SCE Data Response 77) and SCE Data Response 89.

- **Exhibit V-45** provides a reconciliation between the accounting data and the balancing account for the years 2000 and 2001.

Exhibit V-45: Differences Between Accounting Costs and Recorded Expenditures Are Due to Shareholder Incentives and EEPAM Adjustments Which Have Not Been Verified
(Dollars in Thousands)

| | 2000 | 2001 |
|---|-----------------|-----------------|
| EEPAM Expenditures | \$71,915 | \$86,229 |
| Other Operating Revenue | 134 | 64 |
| Adjustments to EEPAM in September and October (not verified) | | 562 |
| Shareholder Performance Incentives | (8,104) | |
| Net CEC Payment Difference | (535) | (681) |
| Year End Adjustment (not incl. in EEPAM until 2003) | 9 | |
| Year End Adjustment to expenses made in January 2002 (not verified) | | (226) |
| Year End Adjustment to expenses made in 2003 (not verified) | | (52) |
| Adjustment of expenses between LIEE and EEPAM made in 2003 | | 5,825 |
| Revised EEPAM Expenses | \$63,419 | \$91,826 |

Source: SCE Data Response 155.

- As of December 31, 2002, SCE's EEPAM showed a balance of (\$105.5) million (spending less than the authorized revenue requirement).

Exhibit V-46: SCE Spent \$105.5 Million less than its Revenue Requirement During the Audit Period
(Dollars in Thousands)

| Program Year | Revenue Requirement | Costs | Interest and Adjustments | Balance |
|----------------|---------------------|----------|--------------------------|--------------------|
| 1998 | (\$90,000) | \$35,563 | | (\$54,437) |
| 1999 | (90,000) | 51,492 | (6,457) | (44,965) |
| 2000 | (90,000) | 71,915 | (7,532) | (25,617) |
| 2001 | (50,000) | 86,229 | (8,505) | 27,724 |
| 2002 | (89,287) | 84,036 | (2,975) | (8,226) |
| Balance | | | | (\$105,521) |

Source: SCE Data Response 89.

4. Recommendations for the Company:

- R6.** SCE should adjust the balancing account in the amount of \$194,509 to account for incorrect charges identified by the audit. Going forward, an additional accuracy check of the accounting coding should be performed by a financial member of the energy efficiency team, prior to submission of the invoices for processing. (Refers to Conclusion No. C14)
- R7.** If possible, SCE should eliminate the practice of advances for advertising. If not, expenditures against advances should be made within the same program year. (Refers to Conclusion No. C15)
- R8.** Recommendations related to procurement practices were provided in Chapter IV. (Refers to Conclusion No. C16)
- R9.** Investigate procurement card violations and eliminate cards as necessary. Enforce the requirement that management review purchases for compliance with corporate and CSBU requirements prior to approving purchases. Future abuses should be dealt with promptly. According to SCE, as a result of our audit procurement cards have been cancelled. (Refers to Conclusion No. C17)
- R10.** The guidelines and methodology used to allocate expenses between PGC and O&M for the CTAC and AgTAC energy centers should be modified to clearly state how the allocations should be handled for all shared expenses. Additional review of CTAC/AgTAC charges should be performed to ensure costs have been accounted for correctly. (Refers to Conclusion No. C18)
- The allocation percentage should be determined at the beginning of each year based on a valid documented study. If the expense is clearly PGC or O&M, then the entire charge should be allocated accordingly. If the expense is a hybrid expense, then the standard allocation percentage should be applied.

- Variations will occur, but they should be clearly noted as a variation, and the supporting documents supporting the new allocation should be included with the payment supporting documentations.

R11. SCE should retain support for all charges associated with energy efficiency programs, regardless of source, while subject to Commission audit. The base rates determined at the beginning of each year should be documented and supported. All charges to PGC programs should be supported including the calculation of the amount charged. All supporting accounting documentation should be retained. (Refers to Conclusion No. C19)

R12. Going forward, human resource/IMM training costs, internet access, desktop and laptop services, telephone services, and radio/communication IMM costs should not be charged to the energy efficiency programs, as these categories of costs were included in the design of base rates. (Refers to Conclusion No. C20)

R13. SCE should confirm the validity of the adjustments made to EEPAM in 2000 and 2001. (Refers to Conclusion No. C21).

14. Policy Issues for the Commission:

None.

Schedule A: SCE 1998-2002 Energy Efficiency Program Expenditures

SCE Program Year 1998 Expenditures
(Dollars in Thousands)

| | 1998 | 1999 | 2000 | 2001 | 2002 | Total |
|--|-----------------|-----------------|----------------|----------------|----------------|-----------------|
| Residential | | | | | | |
| Mass Market Information | \$173 | \$9 | - | - | - | \$181 |
| Local Energy Assistance | 700 | 284 | - | - | - | 984 |
| Major Appliance Labeling | 1,083 | 414 | - | - | - | 1,497 |
| Hardwired Lighting Fixture | 643 | 394 | - | - | - | 1,037 |
| Window/Frame Systems Labeling | 269 | 395 | - | - | - | 664 |
| Home Electronics Labeling | 234 | 134 | - | - | - | 368 |
| Consortium for Energy Efficiency | 196 | 30 | - | - | - | 226 |
| CTAC - Residential Services | 138 | - | - | - | - | 138 |
| Energy Usage Profile Program | 959 | 30 | - | - | - | 989 |
| In-Home Audits | 845 | 175 | - | - | - | 1,020 |
| CHEERS | 292 | 17 | - | - | - | 309 |
| SCE Home | 1,335 | - | - | (52) | - | 1,283 |
| Residential SPC | 355 | 1,370 | 909 | 7 | - | 2,641 |
| Residential Financing | 121 | (1) | - | - | - | 120 |
| Residential Appliance Direct Rebate | 816 | 166 | - | - | - | 981 |
| Residential Spare Refrigerator Recycling | 5,613 | 1,267 | - | - | - | 6,880 |
| Total Residential | \$13,773 | \$4,683 | \$909 | (\$45) | - | \$19,319 |
| Nonresidential | | | | | | |
| EE Support (Showcases) | \$2,131 | \$808 | \$406 | - | - | \$3,346 |
| CTAC - Nonres Services | 2,307 | 2 | - | - | - | 2,309 |
| AMIS | 361 | 44 | - | - | - | 405 |
| MCD Support | 199 | 32 | - | - | - | 231 |
| Third Party Initiatives | 777 | 986 | 40 | - | - | 1,803 |
| Small Business Energy Use Survey | 178 | 64 | - | - | - | 242 |
| Small Business Lighting Modification | 459 | 3 | 1 | - | - | 463 |
| Large Commercial Services | 3,233 | 1 | - | - | - | 3,234 |
| Large Industrial Services | 2,515 | 18 | - | - | - | 2,534 |
| Agricultural Services | 1,023 | 297 | - | - | - | 1,320 |
| Pumping System Efficiency | 528 | 156 | - | - | - | 683 |
| Energy Design Resources | 1,032 | (51) | - | - | - | 981 |
| Incentive Program | 749 | 1,440 | 362 | - | - | 2,551 |
| Commercial and Industrial SPC | 730 | 1,858 | 2,721 | 1,781 | 2,621 | 9,711 |
| Energy Efficiency Incentives | 844 | 1,289 | - | - | - | 2,134 |
| LED Exit Sign Retrofit/Replacement | 1,674 | 259 | - | - | - | 1,934 |
| Total Nonresidential | \$18,742 | \$7,208 | \$3,530 | \$1,781 | \$2,621 | \$33,881 |
| Other | | | | | | |
| MFRR | \$3,057 | \$1,607 | - | - | - | \$4,664 |
| CBEE 1998 Budget | - | 662 | - | - | - | 662 |
| Energy Efficiency Program Total | \$35,571 | \$14,159 | \$4,439 | \$1,736 | \$2,621 | \$58,526 |

**SCE Program Year 1999 Expenditures
(Dollars in Thousands)**

| | 1999 | 2000 | 2001 | 2002 | Total |
|--|-----------------|-----------------|----------------|----------------|-----------------|
| Residential | | | | | |
| Residential Appliance Direct Rebate | \$2,412 | \$898 | - | - | \$3,310 |
| Residential Spare Refrigerator Recycling | 7,716 | 132 | - | - | 7,848 |
| Residential SPC | 744 | 660 | 264 | 147 | 1,816 |
| Energy Usage Profile Audit | 1,072 | 14 | - | - | 1,086 |
| In Home Audits | 726 | - | - | - | 726 |
| AGTAC Residential Services | 61 | - | - | - | 61 |
| CHEERS | 137 | 50 | - | - | 187 |
| CTAC Residential Services | 264 | 2 | - | - | 266 |
| Mass Market Information | 271 | 3 | - | - | 274 |
| Check Me Residential | 151 | (0) | - | - | 151 |
| Consortium for EE | 443 | 50 | - | - | 493 |
| Residential Market Trans Showcases | 258 | 9 | 31 | 106 | 404 |
| Residential Two City Initiatives | 1,050 | - | - | - | 1,050 |
| Upstream - Major Appliances | 2,161 | 191 | - | - | 2,352 |
| Upstream - Lighting | 1,280 | 982 | - | - | 2,262 |
| Upstream - Window/Frames | 208 | 258 | - | - | 467 |
| General Support | 750 | 45 | 9 | 3 | 807 |
| Total Residential | \$19,704 | \$3,294 | \$304 | \$257 | \$23,559 |
| Nonresidential | | | | | |
| Agricultural Services | \$459 | - | - | - | \$459 |
| EEl Agriculture & Pumping Incentives | 297 | - | - | - | 297 |
| Pumping System Efficiency Services | 1,018 | - | - | - | 1,018 |
| Commercial/Industrial SPC | 1,591 | 1,362 | 2,234 | 1,547 | 6,734 |
| Large Commercial Services | 293 | - | - | - | 293 |
| Large Industrial Services | 308 | - | - | - | 308 |
| Small C/I SPC | 541 | 554 | 349 | 143 | 1,588 |
| AGTAC Nonresidential Services | 444 | - | - | - | 444 |
| CTAC Nonresidential Services | 1,049 | 56 | - | - | 1,105 |
| Nonresidential Mass Market Info | 118 | 16 | - | - | 133 |
| Nonresidential Market Trans Showcases | 616 | 773 | 586 | 592 | 2,567 |
| Nonresidential Two City Initiative | 150 | - | - | - | 150 |
| EEl Small Business Incentives | 1,714 | 804 | - | - | 2,518 |
| Small Business Energy Mgmt Services | 268 | (0) | - | - | 268 |
| Small Business Energy Surveys | 226 | 18 | - | - | 244 |
| General Support | 1,102 | 67 | 14 | 4 | 1,187 |
| Total Nonresidential | \$10,195 | \$3,649 | \$3,183 | \$2,287 | \$19,313 |
| New Construction | | | | | |
| EEl Large Industrial Incentive | \$355 | \$111 | \$171 | - | \$637 |
| Energy Design Resource | 1,052 | 14 | - | - | 1,066 |
| NC Incentive Program | 1,167 | 1,199 | 675 | 54 | 3,096 |
| AGTAC Nonresidential Services | 38 | - | - | - | 38 |
| CTAC Nonresidential Services | 108 | - | - | - | 108 |
| Local Government Initiatives | 463 | 116 | - | - | 579 |
| Nonresidential Market Transformation | 618 | 534 | 334 | 77 | 1,563 |
| Residential Market Trans Showcases | 102 | 8 | 4 | 36 | 150 |
| Check Me New Construction | 69 | - | - | - | 69 |
| SCE Sponsored ComfortWise | 1,562 | 166 | - | - | 1,728 |
| AGTAC Residential Services | 40 | - | - | - | 40 |
| CTAC Residential Services | 30 | - | - | - | 30 |
| General Support | 353 | 21 | 4 | 1 | 380 |
| Total New Construction | \$5,957 | \$2,170 | \$1,188 | \$169 | \$9,484 |
| New Construction | | | | | |
| MA&E | \$645 | \$1,399 | \$98 | \$170 | \$2,311 |
| CBEE Operating Budget | 163 | - | - | - | 163 |
| CEC Data Collection | - | 680 | - | - | 680 |
| Energy Efficiency Program Total | \$36,664 | \$11,191 | \$4,773 | \$2,882 | \$55,510 |

SCE Program Year 2000 Expenditures
(Dollars in Thousands)

| | 2000 | 2001 | 2002 | Total |
|--|-----------------|-----------------|----------------|-----------------|
| Residential | | | | |
| Residential Appliance Direct Rebate | \$1,053 | \$425 | - | \$1,478 |
| Residential Spare Refrigerator Recycling | 7,020 | 108 | - | 7,128 |
| Residential SPC | 1,682 | 2,697 | 481 | 4,861 |
| AGTAC Residential Services | 75 | - | - | 75 |
| CHEERS | 256 | 61 | - | 317 |
| CTAC Residential Services | 342 | - | - | 342 |
| Residential Mass Market Information | 168 | (4) | - | 165 |
| Energy Usage Profile Audit | 682 | 50 | - | 732 |
| In-home Audits | 776 | 28 | - | 804 |
| Residential On-line Audits | 152 | 41 | - | 193 |
| Const for EE Residential | 686 | 177 | - | 863 |
| Hardwired Lighting Fixtures | 2,114 | 577 | 25 | 2,716 |
| Major Appliance Labeling | 3,182 | 466 | 25 | 3,673 |
| Residential Check Me Program | 114 | 5 | - | 119 |
| Emerging Technologies | 305 | 80 | 55 | 440 |
| Window Frame Sys Labeling | 463 | 220 | - | 682 |
| Residential TPI Solicitation | 671 | 484 | - | 1,156 |
| Residential Two City Initiatives | 1,100 | - | - | 1,100 |
| General Support | 863 | 41 | 1 | 905 |
| Total Residential | \$21,704 | \$5,457 | \$588 | \$27,749 |
| Nonresidential | | | | |
| Commercial/Industrial SPC | \$1,627 | \$1,572 | \$1,693 | \$4,893 |
| EEl - Agricultural | 273 | 4 | - | 277 |
| Express - Small Business | 1,620 | 1,504 | (3) | 3,120 |
| Express - Upstream HVAC | 645 | 287 | - | 932 |
| Express - Upstream Motors | 732 | 84 | - | 816 |
| NC Savings By Design | 350 | 403 | 442 | 1,194 |
| Small Commercial/Industrial SPC | 704 | 667 | 385 | 1,756 |
| Agricultural Services | 706 | 1 | - | 707 |
| Large Commercial Services | 450 | 176 | - | 626 |
| Large Industrial Services | 511 | 74 | - | 585 |
| Pumping System Efficiency | 1,328 | 1 | - | 1,329 |
| Small Business Energy Mgmt Services | 342 | - | - | 342 |
| Small Business Energy Use Survey | 261 | 52 | - | 313 |
| AGTAC Nonresidential Services | 447 | 8 | - | 454 |
| CTAC Nonresidential Services | 1,278 | 42 | - | 1,320 |
| Nonresidential Mass Market Info | 114 | 37 | - | 151 |
| Nonresidential Check Me Program | 112 | 5 | - | 118 |
| Emerging Technologies | 497 | 425 | 507 | 1,429 |
| Nonresidential TPI Solicitation | 97 | 178 | 44 | 318 |
| Nonresidential Two City Initiative | 500 | - | - | 500 |
| General Support | 1,331 | 63 | 2 | 1,396 |
| Total Nonresidential | \$13,926 | \$5,583 | \$3,070 | \$22,578 |
| New Construction | | | | |
| EEl - Large Industrial | \$299 | \$31 | \$65 | \$394 |
| Incentive Savings By Design | 921 | 1,055 | 531 | 2,507 |
| SCE Sponsored ComfortWise | 2,065 | 76 | 61 | 2,202 |
| AGTAC NC Nonresidential Services | 41 | - | - | 41 |
| AGTAC NC Residential Services | 43 | - | - | 43 |
| CTAC NC Nonresidential Services | 129 | 0 | - | 129 |
| CTAC NC Residential Services | 84 | - | - | 84 |
| Energy Design Resources | 849 | 468 | - | 1,317 |
| Emerging Technologies | 590 | 435 | 79 | 1,105 |
| Local Government Initiatives | 683 | 2 | - | 685 |
| NC TPI Solicitation | 511 | 71 | 282 | 864 |
| NC Two City Initiatives | 400 | - | - | 400 |
| General Support | 271 | 13 | 0 | 284 |
| Total New Construction | \$6,886 | \$2,151 | \$1,019 | \$10,056 |
| Other | | | | |
| MA&E | \$1,728 | \$1,685 | \$241 | \$3,654 |
| CBEE 2000 Operating Budget | 126 | 27 | 0 | 152 |
| Energy Efficiency Program Total | \$44,370 | \$14,902 | \$4,918 | \$64,190 |

**SCE Summer Initiative Expenditures
(Dollars in Thousands)**

| | 2000 | 2001 | 2002 | Total |
|--|----------------|-----------------|----------------|-----------------|
| Residential | | | | |
| Residential Team Proposal | \$1 | \$1,922 | 622 | \$2,545 |
| Pool Pump Efficiency Program | 4 | 2,657 | 77 | 2,738 |
| Refrigerator Recycling (SDG&E) | 354 | (355) | 870 | 869 |
| Refrigerator Recycling (PG&E) | 7 | (92) | 1,757 | 1,672 |
| Refrigerator Recycling (SCE) | 1,200 | - | - | 1,200 |
| Torchiere Replacement | - | 242 | - | 242 |
| Total Residential | \$1,566 | \$4,374 | \$3,326 | \$9,265 |
| Nonresidential | | | | |
| Campus Energy Efficiency Program | \$1,750 | \$1,750 | - | \$3,500 |
| LED Rebate Program | - | 6,046 | 700 | 6,745 |
| Pumping Efficiency Program | - | - | 1,488 | 1,488 |
| Third Party Solicitations | - | 925 | 18 | 943 |
| Total Nonresidential | \$1,750 | \$8,720 | \$2,206 | \$12,676 |
| Other | | | | |
| Administration – Included in PY01 | \$52 | - | - | \$52 |
| Energy Efficiency Program Total | \$3,316 | \$13,094 | \$5,531 | \$21,941 |

**SCE Program Year 2001 Expenditures
(Dollars in Thousands)**

| | 2001 | 2002 | Total |
|--|-----------------|-----------------|-----------------|
| Residential | | | |
| Energy Usage Profile Audit | \$721 | \$3 | \$724 |
| In-Home Audits | 699 | 26 | 725 |
| Residential On-Line Audits | 195 | 2 | 197 |
| Residential RCP - SF | 1,775 | 173 | 1,948 |
| Residential RCP - MF | 1,489 | 811 | 2,300 |
| Residential Home Express | 3,967 | 233 | 4,200 |
| Residential Spare Refrigerator Recycling | 7,500 | (3) | 7,498 |
| RI Major Appliance | 169 | 90 | 259 |
| Hardwired Lighting Fixtures | 2,860 | 93 | 2,953 |
| CHEERS | 182 | 114 | 296 |
| DOE Refrigeration Study | 15 | 95 | 110 |
| Residential Mass Market Information | 540 | 13 | 553 |
| Residential Info Mobil Unit | 372 | 30 | 402 |
| Residential Emerging Technology | 30 | 30 | 60 |
| CTAC Residential Services | 245 | 8 | 253 |
| AGTAC Residential Services | 50 | - | 50 |
| Residential Two City Initiatives | 900 | - | 900 |
| Residential TPI Solicitation | 931 | 1,263 | 2,194 |
| Media Campaign | 1,435 | - | 1,435 |
| General Support | 565 | 64 | 630 |
| Total Residential | \$24,642 | \$3,045 | \$27,688 |
| Nonresidential | | | |
| Small Business Energy Use Survey | \$245 | \$14 | \$259 |
| Small Business Energy Mgmt Services | 390 | - | 390 |
| Large Commercial Services | 483 | 0 | 483 |
| Large Industrial Services | 555 | 0 | 555 |
| Agricultural Services | 652 | - | 652 |
| Pumping System Efficiency | 1,319 | - | 1,319 |
| Express - Small Business | 2,862 | 652 | 3,514 |
| Express Efficiency - Large | 3,940 | 4,400 | 8,339 |
| Commercial and Industrial SPC | 1,701 | 2,055 | 3,756 |
| Small Commercial/Industrial SPC | 654 | 899 | 1,553 |
| Incentive Savings By Design | 520 | 484 | 1,004 |
| Nonresidential Mass Market Info | 262 | 15 | 278 |
| Nonresidential Info Mobil Unit | 124 | 2 | 126 |
| Nonresidential Emerging Technology | 108 | 55 | 163 |
| CTAC Nonresidential Services | 1,264 | 17 | 1,281 |
| AGTAC Nonresidential Services | 494 | 68 | 562 |
| Nonresidential TPI Solicitation | 2,213 | 437 | 2,650 |
| Nonresidential Two City Initiative | 300 | - | 300 |
| Express - Upstream Motors | 353 | (0) | 352 |
| Express - Upstream HVAC | 60 | 10 | 71 |
| Media Campaign | 883 | - | 883 |
| General Support | 1,070 | 122 | 1,192 |
| Total Nonresidential | \$20,453 | \$9,230 | \$29,683 |
| New Construction | | | |
| SCE Sponsored ComfortWise | \$1,036 | \$297 | \$1,333 |
| Energy Design Resources | 101 | - | 101 |
| Savings By Design | 2,351 | 2,789 | 5,140 |
| Local Government Initiative | 341 | 74 | 415 |
| Emerging Technologies | 135 | 203 | 338 |
| CTAC Residential Services | 78 | - | 78 |
| CTAC Nonresidential Services | 153 | - | 153 |
| AGTAC Residential Services | 35 | - | 35 |
| AGTAC Nonresidential Services | 37 | - | 37 |
| TPI Solicitation | 1,060 | 284 | 1,344 |
| Two City Initiatives | 800 | - | 800 |
| Media Campaign | 442 | - | 442 |
| General Support | 384 | 44 | 427 |
| Total New Construction | \$6,954 | \$3,690 | \$10,644 |
| Other | | | |
| MA&E | \$1,434 | \$1,433 | \$2,867 |
| Energy Division Budget | 9 | 14 | 23 |
| Summer Initiatives Admin | 612 | 12 | 623 |
| SERP Refund DSM Money | 3,217 | 678 | 3,895 |
| Energy Efficiency Program Total | \$57,321 | \$18,102 | \$75,423 |

**SCE Program Year 2002 Three Month Expenditures
(Dollars in Thousands)**

| | 2002 |
|--|----------------|
| Residential | |
| Energy Usage Profile Audit | \$11 |
| In-Home Audits | 103 |
| On-Line Audits | 14 |
| Residential RCP-MF | 58 |
| Home Express | 717 |
| Spare Refrigerator Recycling | 912 |
| Hardwired Lighting Fixtures | 44 |
| Mass Market Information | 20 |
| Info Mobil Unit | 98 |
| CTAC Res Services | 56 |
| AGTAC Res Services | 9 |
| R1 Major Appliance | 8 |
| Total Residential | \$2,050 |
| Nonresidential | |
| Small Bus Energy Use Survey | \$46 |
| Small Bus Info Services | 156 |
| Large Commercial Services | 96 |
| Large Industrial Services | 120 |
| Agricultural Services | 111 |
| Pumping System Efficiency | 299 |
| Sm/Med Express | 312 |
| Commercial/Industrial SPC | 586 |
| Large Express Efficiency | 104 |
| Small Comm/Ind SPC | 171 |
| CTAC Nonres Services | 338 |
| AGTAC Nonres Services | 124 |
| Nonres Mass Market Information | 16 |
| Info Mobil Unit | 67 |
| Savings By Design | 72 |
| Emerging Technologies | 40 |
| Total Nonresidential | \$2,659 |
| New Construction | |
| CTAC NC Res Services | \$9 |
| CTAC NC Nonres Services | 22 |
| AGTAC NC Res Services | 5 |
| AGTAC NC Nonres Services | 22 |
| Savings By Design | 815 |
| SCE Sponsored ComfortWise | 211 |
| Energy Design Resources | 14 |
| Emerging Technologies | 38 |
| Total New Construction | \$1,136 |
| Other | |
| MA&E Support | \$153 |
| General Support | 593 |
| Energy Efficiency Program Total | \$6,591 |

**SCE Program Year 2002 Nine Month Expenditures
(Dollars in Thousands)**

| | 2002 |
|--|-----------------|
| Residential Retrofit | |
| Residential Appliance Recycling | \$4,443 |
| Single Family Energy Efficiency Rebates | 4,056 |
| Multifamily Energy Efficiency Rebates | 1,188 |
| Home Energy Efficiency Surveys | 560 |
| Total Residential Retrofit | \$10,248 |
| Residential New Construction | |
| CA Energy Star New Homes - SF | \$1,249 |
| CA Energy Star New Homes - MF | 184 |
| Total Residential New Construction | \$1,434 |
| Nonresidential Retrofit | |
| Standard Performance Contract | \$3,044 |
| Express Efficiency | 3,176 |
| Nonresidential Energy Audit | 1,240 |
| Building Operators Certification | 134 |
| Emerging Technologies | 166 |
| Total Nonresidential Retrofit | \$7,760 |
| Nonresidential New Construction | |
| Savings By Design | \$1,597 |
| Total Nonresidential New Construction | \$1,597 |
| Crosscutting | |
| Education and Training | \$3,297 |
| Energy Centers | - |
| Information Services | - |
| Product Labeling | - |
| Codes & Standards Advocacy | 135 |
| Upstream Residential Lighting | 1,043 |
| Total Crosscutting | \$4,475 |
| Total Statewide Programs | \$25,514 |
| Local Programs - 7 Months | |
| Residential In-Home Energy Surveys | \$533 |
| Small Nonresidential HTR | 796 |
| Pump Test and Hydraulic Services | 1,059 |
| Demonstration and Info. Transfer | 62 |
| Local Government Initiative | 750 |
| Codes and Standards, Local | 4 |
| Local Programs Subtotal | \$3,204 |
| Local Programs - 2 Months | |
| In-Home Audit | \$5 |
| School Based Audits | - |
| Torchiere Turn-In | 78 |
| Small Express HTR | 32 |
| Small/Medium In-Business Audit | 32 |
| Agricultural Information Services, Pumping System Efficiency | 387 |
| Emerging Technologies | 12 |
| Community Energy Efficiency Program | 5 |
| Codes and Standards | 8 |
| Information Mobil Unit | 55 |
| Local Programs Subtotal | \$614 |
| Total Local Programs | \$3,818 |
| Other | |
| MA&E | \$439 |
| Local Third Party | 9,242 |
| SW Marketing and Outreach | 4,659 |
| 2002 CPUC Operating Budget | 82 |
| Energy Efficiency Program Total | \$43,753 |

Schedule B: Confidential Exhibit - Redacted

E. SDG&E

1. Background

SDG&E's total expenditures for energy efficiency programs during the 1998 through 2002 audit period were approximately \$160 million (not including Summer Initiative program costs), divided into the program categories detailed in **Exhibit V-47**.

**Exhibit V-47: SDG&E's 1998-2002 Energy Efficiency Expenditures
Totalled Approximately \$160 Million
(Dollars in Thousands)**

| Program Category | General Program Description | Expenditure Amount |
|--------------------|---|--------------------|
| Residential | Incentives to residential customers to encourage investment in energy efficient products. The incentives were in the form of direct customer rebates, vouchers presented to contractors for a reduced fee, point-of-purchase rebates, and other direct and indirect program participation incentives. | \$56,048 |
| Nonresidential | Programs targeting commercial, industrial, and agricultural businesses providing rebates for numerous measures relating to lighting, process heat, ultra-low-polluting pump and motor retrofits, and various other commercial and industrial energy efficiency measures. | 62,273 |
| New Construction | Incentives to builders to construct homes at least 15 percent more energy efficient than current California code standards. | 26,020 |
| Cross-cutting | Programs with impacts that cut across several program categories, including information and marketing outreach efforts. | 3,054 |
| Summer Initiatives | Statewide and SDG&E specific programs aimed at reducing energy consumption during the summer period. | 12,415 |
| Total | | \$159,810 |

Note 1: Does not include Summer Initiative program costs.

Source: SDG&E-JDH-001-Q2.

Schedule B, attached at the end of this section, summarizes expenditures and represents the financial statements that are the subject of the cost audit.

The last page of the financial statements in **Schedule A** relates to programs included within the Summer Initiatives for the years 2000 through 2002. SDG&E failed to include Summer Initiative program costs in the original databases provided to blueCONSULTING, and did not discover this omission until February 18, 2004, when preparing responses to the auditors' follow-up document requests. Transactions from the supplemental database relating to the Summer Initiatives were subsequently selected for testing.

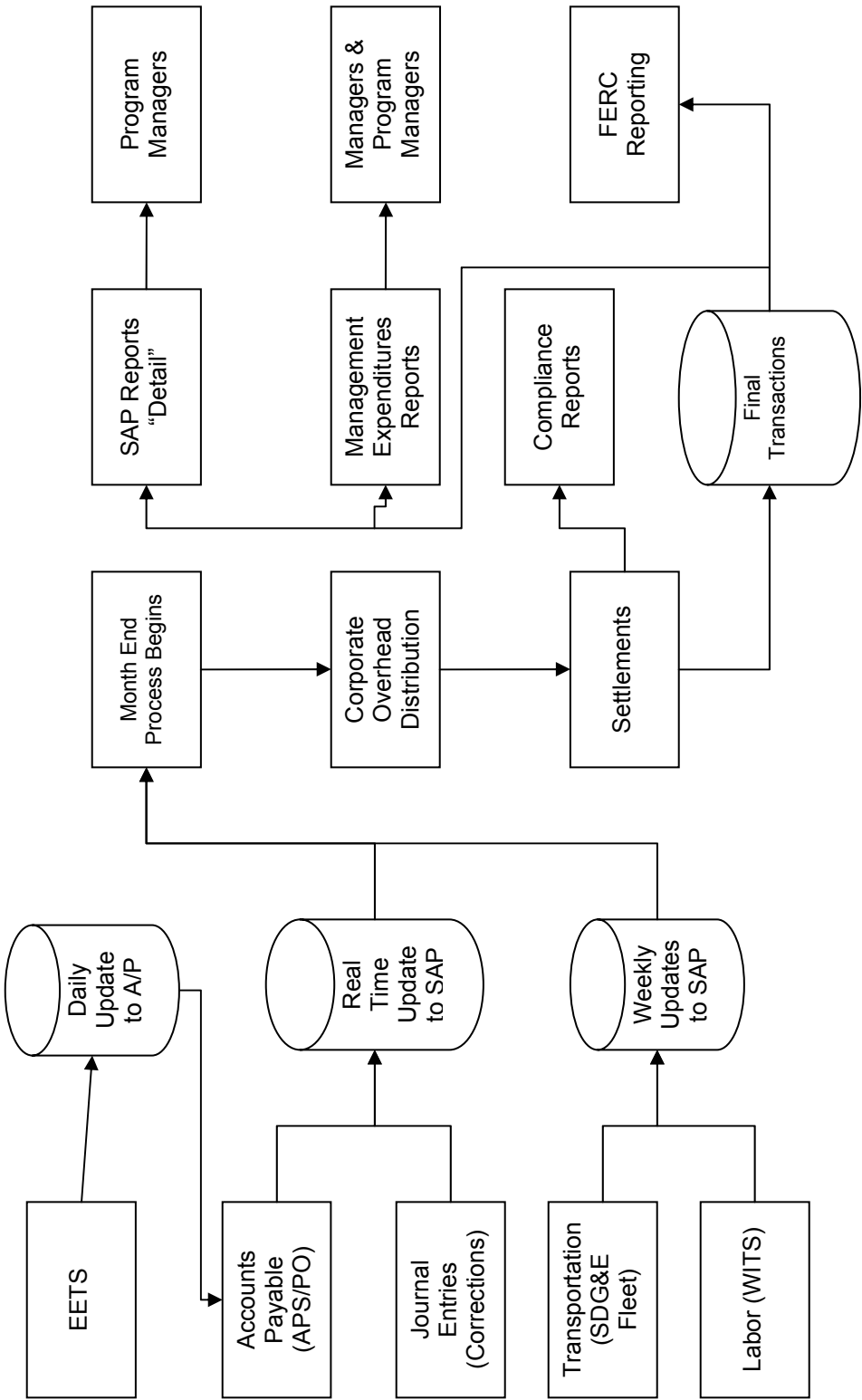
Accounting Systems

SDG&E uses several accounting and project management systems to support its energy efficiency program activities: EETS, SAP, and Workforce Information and Timekeeping Systems (WITS).

EETS is an on-line database system that tracks the details of each rebate and incentive program. Once applications have been confirmed to be complete and appropriate, applications are manually entered into the EETS system by data entry personnel. For some programs, rebate amounts have been pre-loaded into EETS and are selected from drop-down menus. EETS interfaces with SAP, SDG&E's financial accounting system, for payment processing. EETS feeds SDG&E's accounts payable system, which in turn feeds SAP. If an application does not require an inspection, the approved application is electronically transmitted to SAP for payment processing. When inspections are required, EETS applications are held pending the inspection. Once the inspection is complete, data processors release the application for payment in EETS. EETS was designed to meet the specific reporting needs of the Commission and reflects reserved incentive rebates (commitments), installed rebate activity waiting for payment, and paid rebates.

SAP is SDG&E's financial accounting system, and its process is documented in **Exhibit V-48**. This ERP (Enterprise Resource Planning) system was implemented in June 1999. As it relates to the energy efficiency programs, SAP is the primary accounts payable and payment processing system. Transactions are coded using Internal Order (IO) numbers pertaining to specific energy efficiency programs in specific years, and by detailed cost element showing the nature of a particular entry. EETS updates APS daily, which updates SAP on a real time basis. Labor and transportation costs (SDG&E Fleet) update SAP on a weekly basis. Prior to the implementation of SAP, SDG&E used Cost General (CG) as its financial accounting system. In the CG environment, SDG&E used FERC accounts and sub-accounts to record energy efficiency costs for 1998 and part of the 1999 program year. In the SAP environment, SDG&E uses IOs to track program activity costs. There is usually one IO per program per year. However, different IOs are established to track gas and electric program costs, and there will be multiple IOs if there are gas and electric costs in the same program. Costs incurred in a year following the program year will continue to be tracked with the original year IO.

Exhibit V-48: SDG&E SAP Process Flow



Source: SDG&E-RLR-001-Q4a.

Cost elements are used to identify the types of costs being charged to specific programs. There are more than 800 common cost elements used in the reporting of PGC expenditures. Some of SDG&E's cost elements include salaries, employee benefits, purchased materials, purchased services (accounting, food service, legal), contract personnel, and non-purchased services (office equipment, data processing).

Database Summary

Exhibit V-49, which follows, summarizes charges contained in the databases by year and type of charge and provides a reconciliation of the database charges and the financial statements derived from the Company's Annual Reports and shown in Schedule A.

**Exhibit V-49: Adjusted Database Charges Total Approximately \$160 Million from 1998 to 2002
(Dollars in Thousands)**

| Database | 1998 | 1999 | 2000 | 2001 | 2002 | Total |
|--|---------------------|-------------------|-------------------|---------------------|-----------------|------------------|
| Other, mostly vendor charges | \$19,341 | \$14,324 | \$15,730 | \$13,278 | \$4,511 | \$67,184 |
| Rebates and Incentives | 2,276 | 8,200 | 15,507 | 28,636 | 15,035 | 69,655 |
| Labor and labor overheads | 4,902 | 4,131 | 4,883 | 7,478 | 4,463 | 25,856 |
| Total | \$26,519 | \$26,655 | \$36,120 | \$49,392 | \$24,009 | \$162,695 |
| Add (deduct) | | | | | | |
| Error in test database | 63 | (1,054) | (8) | | (8) | (1,007) |
| Manual adjustments | 1 | 130 | (1,215) | (488) | 2,852 | 1,280 |
| Costs from prior period | (262) [Note 1] | | | | | (262) |
| Costs not included in program expenditures | (1,952) [Note 2] | (311) [Note 2] | (807) [Note 2] | (2,362) [Note 3] | 251 [Note 4] | (5,181) |
| Administrative costs not accrued in database | 1,268 [Note 5] | 518 [Note 5] | | 391 [Note 5] | 108 [Note 5] | 2,285 |
| Adjusted Database Totals | \$25,637 | \$25,938 | \$34,090 | \$46,933 | \$27,212 | \$159,810 |
| Equals Financial Statement Totals | \$25,637 | \$25,938 | 34,090 | \$46,933 | \$27,212 | \$159,810 |

Note 1: MA&E CBEE transactions in database not in annual report.

Note 2: MA&E transactions in database not in annual report.

Note 3: MA&E transactions (1,022) and Statewide Marketing costs (1,340) in database not in annual report.

Note 4: MA&E transactions (346) and Statewide Marketing costs (minus 95) in database not in annual report.

Note 5: Future administrative costs related to committed incentives reported in Technical Appendix not in database.

Source: Databases provided in response to DR SDG&E JDH-004 through JDH-008 and blueCONSULTING analysis

Intercompany Settlements represent SCG billings to SDG&E for energy efficiency program related activities. For 2002, Intercompany Settlements are included in the database for Other Transactions.

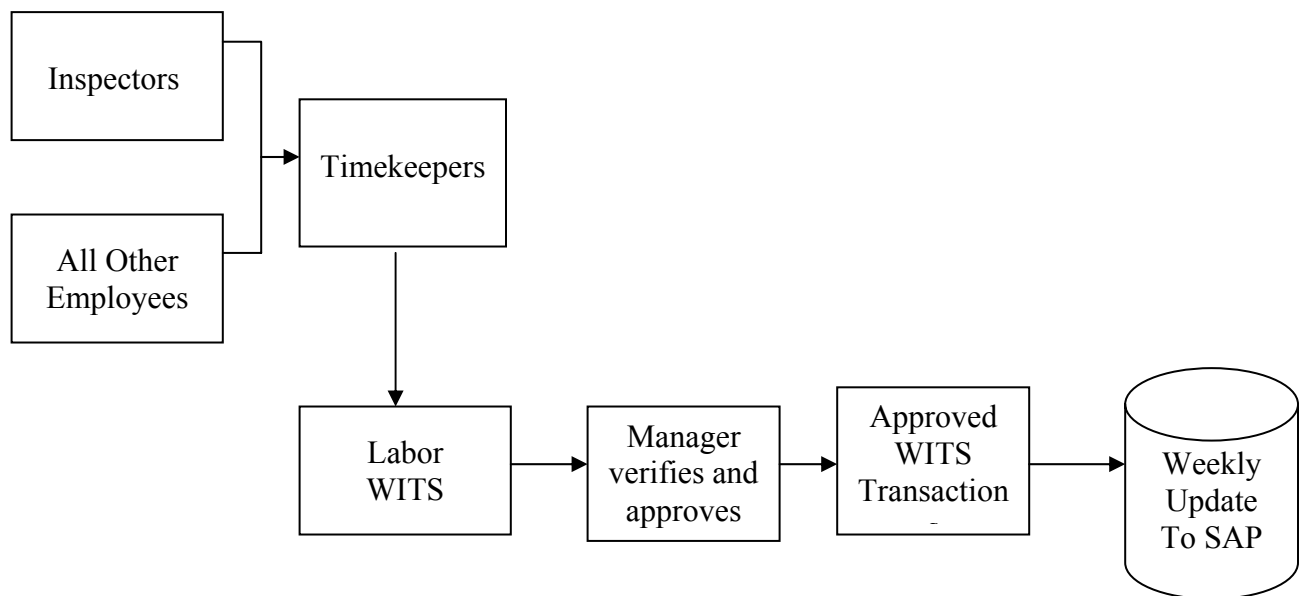
Labor Charges

SDG&E uses Workforce Information & Timekeeping System (WITS) to enter and track labor hours and costs. **Exhibit V-50** illustrates WITS' process. This system was in place for all five years of the audit period. Timekeepers located in each major department, including those responsible for energy efficiency program administration, are responsible for ensuring proper

employee labor input. Managers are responsible for verifying all reported time. Almost all of the employees involved in the energy efficiency programs will use standard time distribution with exception time reporting. Based upon a predetermined allocation, an employee's time is automatically distributed among their main tasks unless the employee manually enters another task to which their time should be allocated. These predetermined allocations are periodically reviewed and adjusted. Inspectors enter their time on timesheets.

As discussed more fully in the labor cost section, we determined the Company has no standard requirement pertaining to documentation of information entered into WITS and no formal payroll records retention policy. Accordingly, the Company was unable to provide sufficient documentation for many of the energy efficiency labor charges selected for testing.

Exhibit V-50: WITS Process Flow



Source: SDG&E-RLR-001-Q4.

For the audit, we obtained a database of WITS information with distinct fields for:

- Employee Number
- Internal Order (energy efficiency program or other account)
- Cost Element (type of cost category)
- Cost Center (organizational unit)
- Transaction Date
- Transaction Amount
- Transaction Posting Date.

A summary of labor charges by year is provided in **Exhibit V-51** below.

**Exhibit V-51: Summary of Database Charges Shows Build-Up of Labor Force in 2001
(Dollars in Thousands)**

| Employee Salary Category | 1998 | 1999 | 2000 | 2001 | 2002 | Total [Note 1] |
|-------------------------------------|----------------------------|----------------|----------------|----------------|----------------|-------------------|
| Management | | \$1,651 | \$2,091 | \$3,484 | \$2,176 | \$9,401 |
| Clerical and Technical | Detail Not Available | 259 | 414 | 785 | 496 | 1,954 |
| Union Worker | | 2 | 4 | 1 | 0 | 7 |
| Temporary Employee | | 638 | 455 | 111 | 24 | 1,228 |
| Overtime Pay (all classes) | | 51 | 82 | 101 | 46 | 280 |
| Intercompany Settlements | | 30 | 31 | 78 | | 139 |
| Subtotal Direct Labor | 3,386 | 2,631 | 3,077 | 4,560 | 2,741 | 16,396 |
| Labor overheads and other | 1,515 | 1,501 | 1,806 | 2,871 | 1,717 | 9,410 |
| Total | \$4,901 | \$4,132 | \$4,883 | \$7,432 | \$4,458 | \$25,806 |
| Number of Employees [2] | 186 | 171 | 170 | 215 | 151 | 178 |
| Average labor cost per employee [3] | 26.3 | 24.2 | 28.7 | 34.6 | 29.5 | |

Note 1: Column does not foot down to subtotal due to missing 1998 data.

Note 2: Number represents line items in the database with associated employee numbers.

Note 3: This average is not a wage per full time equivalent (FTE) employee. Instead, it is the average amount of energy efficiency labor for all employees involved in program activities.

Source: Labor databases provided in response to DR SDG&E JDH-004, including Summer Initiative supplement received 2-18-04, and blueCONSULTING analysis.

The build-up in the energy efficiency labor force in 2001 reflects the Commission's response to the energy crisis. SDG&E added personnel to help achieve the Commission's energy savings and demand reduction goals, and continue implementation of the Summer Initiatives started in 2000. In 2002, the Commission reduced program budgets and SDG&E responded by reducing staff. The 2002 staff reductions involved reduced support from other company departments including account executives, customer service representatives, and special investigators, and non-renewal of contracts with contract employees.

2. Summary of Adjustments

Although some SDG&E energy efficiency charges are not adequately supported, we have not proposed specific adjustments because audit tests do not provide conclusive evidence that adjustments are needed.

3. Conclusions:

C22. Documentation of employee labor charges to energy efficiency programs is inadequate. We are unable to conclude direct labor costs relating to energy efficiency program delivery are reasonable and properly classified in accordance with applicable accounting principles and regulatory requirements because of the large number of exceptions in the test sample.

- Labor charge documentation is inadequate because SDG&E only provided approximately half of the original employee time records requested in the audit.
- **Exhibit V-52** provides a summary of the type of documentation provided by SDG&E in support of energy efficiency labor charges.

Exhibit V-52: Summary of Labor Cost Documentation

| Total Test Population | 1998 | 1999 | 2000 | 2001 | 2002 | Total [Note 1] |
|--|------|------|------|------|------|----------------|
| Named Employees | 7 | 8 | 8 | 12 | 15 | 15 |
| Energy efficiency Cost Centers | 9 | 18 | 9 | 14 | 10 | 21 |
| Non-energy efficiency Cost Centers | 6 | 9 | 9 | 8 | 9 | 10 |
| Total Sample Size | 22 | 35 | 26 | 34 | 34 | 46 |
| Documentation Provided | | | | | | |
| WITS Screen Print | | | | | | |
| ▪ Provided | 8 | 11 | 10 | 15 | 14 | 58 |
| ▪ Not Provided | 14 | 24 | 16 | 19 | 20 | 93 |
| Fixed Distribution Analysis or Time Record | | | | | | |
| ▪ Provided | 18 | 24 | 18 | 21 | 18 | 99 |
| ▪ Not Provided | 4 | 11 | 8 | 13 | 16 | 52 |
| Exception Reports | None | None | None | 1 | 4 | 5 |

Note 1: Total for test population is the number of employees selected in each type of sample. Totals for each year are the number of employees in the test population with labor charges in that year.

Source: Labor databases provided in response to DR SDG&E JDH-004, labor cost documentation provided in response to DR JDH-006 and blueCONSULTING analysis.

- ⇒ Timekeepers enter information into WITS based on Fixed Distribution (with exception reporting) for most management employees and from time sheets prepared by inspectors, auditors and other field personnel. Area managers approve time for each accounting period using an on-line approval system that is password protected.
- ⇒ There is no corporate policy relating to records retention following data entry. Procedures relating to documentation supporting data entry are left to the discretion of each area manager or the area timekeeper.
- ⇒ Labor charges in the labor database we were provided agree with the WITS distribution, since WITS was the source for development of the database. However, without a Fixed Distribution Analysis or Time Record for each employee in our test sample, labor distribution in WITS is not adequately supported in the audit.
- For the employees selected by name, we were able to review the distribution of their total labor hours for each year of energy efficiency program involvement.
- ⇒ Based upon our review of organization charts, position descriptions and interviews, charges to energy efficiency program Internal Orders were reasonable.
- ⇒ However, as discussed in Conclusion No. 23 below, detailed testing produced a number of exceptions.
- For the employees selected by employee number, we found no significant exceptions in our review of original time records provided by SDG&E for about half of the employees selected.

- Most employees assigned to non-energy efficiency cost centers were assigned to related cost centers. For example, several employees are splitting time between energy efficiency Program and Direct Assistance Program (DAP) activities, and some Customer Services personnel charge time to energy efficiency program energy audit activities in connection with their investigation of high bill complaints.

C23. SDG&E has properly accounted for energy efficiency employee total compensation.^{vii} However, distribution of labor charges to energy efficiency programs is not adequately supported.

- **Exhibit V-53** on the pages following shows the distribution of labor charges for one energy efficiency employee in each year of the audit, and a calculation of annual earnings using energy efficiency dollars in the database. This exhibit also shows a reconciliation of calculated compensation and actual W-2 earnings using information provided by SDG&E.
 - ⇒ All differences between calculated and actual amounts of total compensation are reasonable based upon this rough test.
 - ⇒ Reconciling items including Incentive Compensation and the Cafeteria Plan deduction were expected and are reasonable in amount.
 - ⇒ Lump sum payments as reconciling items in 1998 and 1999 were not expected and cannot be investigated within the time frame of the audit. However, because of the Company's controls over compensation payments, it is likely that documentation if available would provide an adequate explanation of these payments.

Exhibit V-53: Confidential Exhibit - Redacted

- Fixed distribution work papers prepared annually by the Consumer Programs & Services group (or other applicable cost center) are available for all of the employees in this test sample. However, the work papers do not support all of the labor charges, and exception reports were seldom provided.
 - ⇒ In 1998, the fixed distribution work paper reflects a 68 percent allocation to the Electric Incentives program and a 32 percent allocation to the Gas Incentives program. Actual distribution is 85 percent to electric and 15 percent to gas. Further, there is no support for the small number of hours charged to Measurement & Evaluation (M&E) activities.
 - ⇒ In 1999, the fixed distribution work papers reflect a 21 percent allocation of total time to four energy efficiency programs, whereas actual distribution is about 23 percent. Exception reports were not provided, nor do we know how the actual distribution to the Customer Records and Collections account was determined.

^{vii} Based upon audit team's reconciliations of amounts included in the energy efficiency labor database with total W-2 earnings for selected employees.

- ⇒ In 2001, the fixed distribution work paper shows a five percent allocation to each of five accounts, 20 percent to the In-Store Energy Efficiency Demo program, and 55 percent to the Residential Contractor Program. Actual distribution was about two percent to each of the five accounts, only seven percent to the In-Store Demo program, with the remaining 84 percent to the Residential Contractor Program. Exception reports were not provided.
- ⇒ In 2002, labor distribution for the selected employee was determined both before and after the integration of SDG&E and SCG operations. The post integration actual distribution was subsequently changed and is supported by an exception report.

C24. In some cases, SDG&E is not receiving adequate value for its expenditure of energy efficiency labor dollars.

- During the 1998-2002 audit period, there were approximately 165 employees who charged less than \$1,000 annually to energy efficiency program costs for a total of \$52,000. It is likely employees with this low level of involvement are not making a significant contribution to the accomplishment of energy efficiency program objectives.
- Based upon our detailed tests of employee time charges, Customer Services Representatives and other employees who are asked to staff display booths at community outreach events are often paid at overtime rates. During the 1999-2002 timeframe, a total of \$276,000 was paid for overtime from energy efficiency program funds.

C25. Charges contained in the database of “other” charges are primarily vendor payments. In general, they are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements. However, audit tests reveal a number of departures from established corporate policy.

- **Exhibit V-54** provides a summary by major vendor in our test sample of amounts contained in the database of other charges. An explanation of the types of goods and services provided follows the exhibit.

Exhibit V-54: Confidential Exhibit - Redacted

- Major activities performed by the selected vendors in support of energy efficiency program objectives include:
 - ⇒ Vendor A (**vendor name redacted for reasons of confidentiality**): provided temporary personnel services to SDG&E, including the Energy Efficiency programs. A number of charges relate to personnel used to staff trades show exhibits.
 - ⇒ Vendor B (**vendor name redacted for reasons of confidentiality**): provided advertising services promoting the various SDG&E Energy Efficiency programs and products.

- ⇒ Vendor C (**vendor name redacted for reasons of confidentiality**): provided customer response management support, including processing requests and mailing self-audit kits and other materials requested by consumers.
- ⇒ Vendor D (**vendor name redacted for reasons of confidentiality**): provided consulting services to support the Savings by Design Program. Services included the preparation of program rules, policies, and procedures; the creation of forms, applications, and contracts; the revision of unit energy savings tables and incentive structure; the generation of program brochures, and the training of utility personnel.
- ⇒ Vendor E (**vendor name redacted for reasons of confidentiality**): provided various types of engineering services, including developing efficiency standards and contractor training.
- ⇒ Vendor F (**vendor name redacted for reasons of confidentiality**): provided printing services including printing informational material such as inserts, flyers, and booklets designed to advertise SDG&E's energy efficiency programs.
- ⇒ Vendor G (**vendor name redacted for reasons of confidentiality**): provided the design, setup, and staffing of information booths used to promote consumer awareness at fairs and other community events.
- ⇒ Vendor H (**vendor name redacted for reasons of confidentiality**): this media group provided advertising services for SDG&E's Energy Efficiency programs. SDG&E's Corporate Communications Department facilitates the purchase of these services for all of SDG&E's departments and programs.

C26. SDG&E has entered into questionable business relationships with two former employees.

- During the audit, we reviewed a number of contracts with Vendor X (**vendor name redacted for reasons of confidentiality**), later changed to Vendor X1 (**vendor name redacted for reasons of confidentiality**), for consulting services related to on-going energy efficiency efforts such as program tracking, system support, process review and evaluation, systems development and documentation, year-end program report development and support, and development of reporting systems needed for regulatory reporting.
- ⇒ (**Employee name redacted for reasons of confidentiality**) was an employee who resigned from SDG&E in 1985. He returned as a temporary agency employee in 1991 through mid-1994. In 1994 it was determined that his skills continued to be needed, and he was awarded a consulting contract with SDG&E.
- ⇒ A January 6, 2000, contract had a completion date of December 31, 2000 and a not-to-exceed amount of \$150,000. A later contract for \$200,000 (Contract SSA 5600000459) received a change order dated December 4, 2000 that increased the

- contract's not-to-exceed amount from \$200,000 to \$900,000 and extended the expiration date to December 31, 2002.
- During the audit, we also reviewed a contract with Vendor Y (**vendor name redacted for reasons of confidentiality**) for consulting services related to the development of EETS program tracking and reporting systems and other related technical assistance.
 - ⇒ Vendor Y was awarded two contracts - an August 16, 2000 contract (5600003576) for \$130,000, with a completion date of December 31, 2000, which was increased to \$192,000 and extended to July 15, 2002; and an August 1, 2002 contract (5600008583) for \$100,000 with a completion date of July 31, 2003.
 - ⇒ During the time period that Vendor Y held contracts with SDG&E; he was also working on SDG&E projects on behalf of Vendor X. In the months of March, July, and August 2001, Vendor X billed SDG&E for 43, 21, and 38 hours of Vendor Y time, respectively.
 - ⇒ Vendor Y held temporary and contract positions with SDG&E (when confirming Vendor Y's employment history, SDG&E did not provide dates).
 - Until recently, there were no special procedures to be followed before entering into contracts with former employees, and these contracts were approved through the established management approval process. (**Discussion of changes redacted for reasons of confidentiality**).
 - In addition to the above, there were several exceptions or errors noted in reviewing the purchase orders and related invoices submitted by Vendor X:
 - ⇒ Travel reimbursement claims included meals at which the contractor hosted SDG&E employees.
 - ⇒ The contractor's invoices did not include receipts to support all travel expense claims.
 - ⇒ The contract in effect in 1998 allowed for a ten percent discount if the contractor billed more than 80 hours per month. In September, 1998 the contractor billed 147 hours with no discount given.
 - ⇒ The not-to-exceed amount was exceeded for contract 5600002053, and invoices were then charged to contract 5600000459.
 - ⇒ There was no evidence that a competitive bidding process was used to secure the services provided by Vendor X.

C27. The invoicing and purchase order processes lack adequate controls.

- Individuals approved invoices in amounts greater than allowed by their delegated approval levels.

- ⇒ One employee had a delegated approval level of \$25,000. She approved transaction 11010779525 in the amount of \$36,567.
- ⇒ Another employee had a delegated approval level of \$5,000. She approved transaction 11000579525 for \$6,761 and transaction 882679525 for \$5,745.
- ⇒ A third employee had a delegated approval level of \$5,000 and approved one transaction for \$43,494.
- ⇒ In addition to the above, audit tests determined three employees without signature authority or delegated signature authority authorized payment of invoices during the audit period.
- Vendors did not always submit required receipts when requesting reimbursement for travel expenditures. The following vendors submitted invoices in 1998 that did not include travel receipts:
 - ⇒ Vendor X
 - ⇒ Vendor I
 - ⇒ Vendor E.
- Purchase orders were not always obtained when the purchase amount exceeded the minimum amount for which a purchase order is required.
 - ⇒ Vendor G consistently provided services during the audit period without benefit of a contract or purchase order. The 60 transactions we sampled totaled over \$139,000. Twenty-three transactions each stemmed from invoices that alone were above the threshold at which a purchase order is required.
 - ⇒ Vendor E did not have a contract or purchase order in 1999. Our sample contained eight transactions that totaled over \$177,000.
- Invoice processing and accounts payable personnel made some errors and omissions during the audit period.
 - ⇒ Invoices were entered into the accounting system and paid without referencing the purchase order or contract number. The purchase order reference is needed to ensure that the invoice payments do not exceed the total amount allowed by the purchase order.
 - ⇒ Payments without reference to the purchase order included the following vendors and document numbers:
 - **Vendor names and document numbers redacted for reasons of confidentiality.**

- ⇒ Audit tests indicate it was common practice to allow the Accounts Payable Department to release vendor payments to the energy efficiency staff requesting vendor payment, rather than having Accounts Payable mail checks directly to the vendors. This practice was discontinued in 2002.
- ⇒ In some cases, transactions were allocated to cost elements that did not appear to be an accurate description of the service provided. Invoices from **(vendor name redacted for reasons of confidentiality)** were recorded as food and beverage costs (transaction 2470105 for \$114,216 and 2843845 for \$74,344).

C28. Charges contained in the Rebates and Incentives database are adequately supported, appear reasonable and are properly classified as energy efficiency program costs in accordance with applicable accounting principles and regulatory requirements. However, audit tests reveal a number of departures from program requirements.

- **Exhibit V-55** provides a summary by major program of amounts contained in the rebates and incentives database.

Exhibit V-55: Nonresidential Programs Accounted for 45% of Rebate and Incentive Expenditures During the Audit Period, and 41% of the Total Rebates and Incentives Were Expended in 2001 (Dollars in Thousands)

| Program Name | 1998 | 1999 | 2000 | 2001 | 2002 | Total |
|---------------------------------------|----------------|----------------|-----------------|-----------------|-----------------|-----------------|
| Residential | | | | | | |
| Information | | | \$4 | | \$45 | \$49 |
| EMS | (\$3) | | 5 | | | 2 |
| EEI | | \$608 | \$4,750 | \$5,137 | \$5,674 | \$16,169 |
| Upstream Programs | 353 | | 554 | 1,395 | (12) | 2,290 |
| Total Residential | \$350 | \$608 | \$5,313 | \$6,532 | \$5,707 | \$18,510 |
| Nonresidential | | | | | | |
| Information | | \$501 | \$290 | \$150 | (\$51) | \$890 |
| EEI | 931 | 5,410 | 7,585 | 9,100 | 5,519 | 28,545 |
| Upstream Programs | 996 | 297 | 416 | 282 | (110) | 1,881 |
| Total Nonresidential | \$1,927 | \$6,208 | \$8,291 | \$9,632 | \$5,358 | \$31,416 |
| New Construction | | | | | | |
| Residential | | | \$155 | \$1,426 | \$1,635 | \$3,216 |
| Nonresidential | | \$1,383 | 1,306 | 3,431 | 1,940 | 8,060 |
| Total New Construction | | \$1,383 | \$1,461 | \$4,857 | \$3,575 | \$11,276 |
| Summer Initiatives | | | \$443 | \$7,616 | \$394 | \$8,453 |
| Total Rebates & Incentives | \$2,277 | \$8,199 | \$15,508 | \$28,637 | \$15,034 | \$69,655 |

Source: Database of rebates and incentives provided in response to DR SDG&E JDH-004, and supporting documentation provided in response to DR JDH-007 through JDH-0010 and blueCONSULTING analysis

- Audit tests of approximately 100 transactions indicate a few Rebates and Incentives transactions had incomplete documentation, or were not processed in strict compliance with applicable rules and regulations.
- ⇒ Five Rebate and Incentive transactions reviewed lack a completed application.

⇒ Fourteen transactions did not have the inspection report signed by the customer as required.

C29. Labor-related overheads included in energy efficiency program costs are properly supported by current cost allocation studies, and the basis for allocation is appropriate and reasonable.

- Overhead account balances are monitored closely against year-end targets and rates are adjusted as needed to keep balances in line.
- By long established precedent, SDG&E does not make periodic accounting adjustments to keep balances in line.

C30. SDG&E provided an inadequate explanation and was unable to support the amount of Material Procurement & Logistics (MP&L) overheads included in energy efficiency program costs.

- MP&L is an overhead charge to energy efficiency program costs to recover the expenses of procuring materials and services. These expenses include salaries, employee expenses, materials and supplies and purchased services relating to the procurement function. During the audit, we obtained a list of IOs that make up the loading base and the rates in effect during the period from 1999 through 2002.
- Tests of recorded MP&L produced wide variances as summarized in **Exhibit V-56** below. SDG&E did not provide an adequate response to our follow-up requests for information before completion of the audit. However, during the verification process, Company representatives expressed confidence that the differences result from the nature of the auditors' tests and do not indicate that adjustments might be needed.

**Exhibit V-56: There Are Wide Variances in Recorded Material Procurement & Logistics Overhead Charges Throughout the Audit Period
(Dollars in Thousands)**

| Descriptive Captions | 1998 | 1999 | 2000 | 2001 | 2002 |
|--|------|--------------|---------------|--------------|--------------|
| Base for MP&L Loading | NA | \$8,341 | \$12,531 | \$8,856 | \$3,322 |
| Average Annual MP&L Loading Rate | | 0.77% | 1.88% | 0.73% | 0.40% |
| Computed Amount | | \$64 | \$236 | \$65 | \$16 |
| Actual Recorded Amount | | 184 | 167 | 148 | 98 |
| Difference Actual Over (Under) Computed Amount | | \$120 | \$(69) | \$83 | \$82 |
| Percent Difference | | 65.1% | -41.0% | 56.2% | 83.4% |

Source: blueCONSULTING analysis using information contained in Other transactions database provided in response to DR SDG&E-JDH-004 and MP&L rates provided in response to questions raised in a 1-21-04 interview.

C31. The cost of employee use of assigned vehicles charged to energy efficiency program costs is reasonable. However, the Company did not adequately answer our request for information regarding the vehicle use rate.

- The WITS system is used to capture hours of assigned vehicle use and the distribution of costs parallels labor distribution.
- During the period from 1999 – 2002, the cost of employee vehicle use charged to energy efficiency program costs in Cost Element 6260004 ranged from about \$12,000 to \$44,000 per year and totaled \$110,000 for the four-year period.
- During the audit, we reviewed the basis for the calculation of the cost related to a vehicle assigned to one of the inspectors in our labor test sample. We determined vehicle cost is based on hours from the WITS system and a \$4.25 per hour vehicle use rate for a Ford Ranger pickup used for field inspections.
- The Company did not provide a response to our request for support for the calculation of the \$4.25 per hour rate. (Equivalent to \$7,650 per year based on 1,800 hours of use.)

C32. In addition to the allocated costs discussed above, energy efficiency program costs include certain other direct and indirect costs that might typically be considered overheads.

- From 1999 through 2002, energy efficiency program costs include \$936,000 for Leased Office Space recorded in Cost Element 6400375. Such costs range from \$189,000 to \$277,000 per year.
- From 1999 through 2002, energy efficiency program costs include \$318,000 for Computer Hardware charged to Cost Element 6213180. Such costs range from \$48,000 to \$110,000 per year.

C33. Energy efficiency program costs do not include certain other types of indirect costs that might typically be considered overheads.

- Although pension and medical benefit costs are charged to capital projects, such costs are not included in energy efficiency program costs.
- SDG&E explained that such costs are recovered in base rates relating to electric and gas distribution services. Recording them as a labor related overhead in energy efficiency program costs would result in double recovery through base rates and the energy efficiency balancing account.

4. Recommendations for the Company:

R14. The Corporate Controller should review current practices relating to WITS system data entry and records retention for energy efficiency labor charges to ensure that future charges are adequately supported. (Refers to Conclusions No. C22 and C23)

- R15. Energy efficiency program management personnel should eliminate the need for payment of overtime premiums to customer services and other personnel asked to staff display booths at community outreach events. Arrangements for compensatory time off from the person's regular assignment might eliminate the overtime situation. (Refers to Conclusion No. C24)**
- R16. SDG&E should enforce its established policies and procedures relating to procurement of energy efficiency goods and services including approval of contracts with former employees by the Sempra Energy Project Review Committee, use of competitive bidding practices, proper documentation for vendor travel and entertainment expenses, approval authorities, and data entry. (Refers to Conclusions No. C25 through C30).**
- R17. SDG&E should investigate the reasons for the apparent MP&L discrepancies noted in the audit and make appropriate adjustments, if necessary. (Refers to Conclusion No. C30).**

5. Policy Issues for the Commission:

None.

Schedule A: SDG&E Energy Efficiency Program Expenditures**SDG&E Expenditures for the Period Ending December 31, 1998**

| | |
|---|---------------------|
| Residential Programs | |
| Residential Information & EnergyWise Contractor | \$937,320 |
| Residential Audits | 1,515,366 |
| Residential SPC | 4,082,705 |
| Residential Energy Efficiency Clothes Washers | 483,089 |
| Residential Fixtures | 1,653,051 |
| Energy Star | 629,479 |
| Third Party Initiatives | 1,411,993 |
| Residential Total | \$10,713,003 |
| Nonresidential Programs | |
| Nonresidential Information | 206,077 |
| Energy Cents | 99,702 |
| Building Operator Certification | 119,841 |
| Small Commercial Audits | 654,707 |
| Small Commercial Rebates | 1,430,408 |
| Energy Efficient Motors | 276,375 |
| Nonresidential SPC | 9,369,969 |
| Nonresidential Total | \$12,157,079 |
| New Construction Programs | |
| Nonresidential Energy Design Assistance | 163,923 |
| Savings through Design | 2,422,849 |
| Residential Energy Design Assistance | 179,912 |
| New Construction Total | \$2,766,684 |
| Energy Efficiency Program Total | \$25,636,766 |

Source: SDG&E-JDH-001-Q2

SDG&E Expenditures for the Period Ending December 31, 1999

| Residential Programs | |
|---|---------------------|
| Statewide Energy Guide | \$92,605 |
| Energy Efficiency Mortgage Program | 202,321 |
| Information & Education | 1,285,169 |
| In-Store Energy Efficiency Demonstration Co-op Program | 173,759 |
| Energy Management Services | 1,205,778 |
| Time of Sale Home Energy Rating | 190,689 |
| Residential Contractor Program | 1,430,226 |
| Downstream Appliance Incentives | 1,006,722 |
| Contractor Training Program (HVAC) | 149,226 |
| Statewide Upstream Appliances | 738,920 |
| Energywise Contractor Program | 514,715 |
| Energy Star Windows Program | 83,350 |
| Targeted Third Party Initiatives | 1,657 |
| Upstream Distributor Incentive Program | 483,056 |
| Statewide Upstream Lighting | 1,602,564 |
| Residential Lighting Fixtures | 1,221,858 |
| Residential Total | \$10,382,615 |
| Nonresidential Programs | |
| Small Commercial Info | \$157,439 |
| Large Commercial Info | 81,808 |
| Process Info | 49,218 |
| HVAC Info | 140,088 |
| Technical assistance HVAC | 21,580 |
| Motors Info | 48,778 |
| Technical Assistance Motors | 33,360 |
| Energy Efficiency Financing (Energy Cents) | 126,033 |
| Technical Assistance, Small Comprehensive | 86,351 |
| Technical Assistance, Process | 64,278 |
| Small Commercial Audits | 484,891 |
| Tenant Improvements | 855,053 |
| Express Efficiency | 2,518,220 |
| Nonresidential Standard performance Contract (NRSPC) | 4,664,898 |
| Small Business SPC (SBSPC) | 524,359 |
| Targeted TPI (Small Cities energy efficiency Retrofit Demo) | 258,918 |
| Commercial Horizontal Washers | 115,165 |
| Upstream HVAC Incentives | 314,185 |
| Upstream Motors Incentives | 103,370 |
| Nonresidential Total | \$10,647,992 |

SDG&E Expenditures for the Period Ending December 31, 1999

| New Construction | |
|--|---------------------|
| Statewide Programs (Manufactured Housing) | \$41,739 |
| Residential Design Assistance | 1,833,867 |
| CHEERS | 61,441 |
| CEC Public Interest Energy Research (PIER) | 43,069 |
| Targeted Third Party Initiatives (TPI) | 170,376 |
| Savings by Design | 1,648,951 |
| Energy Design Resources | 610,558 |
| Relocatable Classrooms | 99,310 |
| New Construction Codes and Standards Support | 397,781 |
| New Construction Total | \$4,907,092 |
| Energy Efficiency Program Total | \$25,937,699 |

Source: SDG&E-JDH-001-Q2.

SDG&E Expenditures for the Period Ending December 31, 2000

| Residential Programs | |
|--|---------------------|
| Statewide Energy Guide | \$39,826 |
| Energy Efficiency Mortgage Program | 184,333 |
| Information & Education | 1,062,652 |
| In-Store Energy Efficiency Demonstration Co-op Program | 187,684 |
| Energy Management Services | 1,561,566 |
| Time of Sale Home Energy Rating | 215,600 |
| Residential Contractor Program | 3,325,760 |
| Downstream Appliance Incentives | 1,126,291 |
| Contractor Training Program (HVAC) | 226,918 |
| Statewide Upstream Appliances | 1,059,736 |
| Energy Star Windows Program | 482,599 |
| Targeted Third Party Initiatives | 18,469 |
| Upstream Distributor Incentive Program | 515,878 |
| Statewide Upstream Lighting | 2,308,436 |
| Residential Total | \$12,315,748 |
| Nonresidential Programs | |
| Small Commercial Info | \$472,448 |
| Large Commercial Info | 218,934 |
| Process Info | 34,148 |
| HVAC Info | 59,650 |
| Motors Info | 27,711 |
| Emerging Technologies | 123,863 |
| Energy Efficiency Financing (Energy Cents) | 12,468 |
| Technical Assistance, Small Comprehensive | 116,321 |
| Building Operator Certificate | 64,428 |
| Technical Assistance, Process | 302,413 |
| Small Commercial Audits | 391,474 |
| Targeted Third Party | 153,504 |
| Tenant Improvements | 972,445 |
| Express Efficiency | 3,873,442 |
| Commercial Horizontal Washers | 244,267 |
| Turnkey Pilot/EZ Turnkey | 225,844 |
| Nonresidential Standard performance Contract (NRSPC) | 6,376,825 |
| Small Business SPC (SBSPC) | 773,755 |
| Commercial Dishwasher Pilot | 185,014 |
| Upstream HVAC Incentives | 699,376 |
| Upstream Motors Incentives | 145,847 |
| Nonresidential Total | \$15,474,177 |

SDG&E Expenditures for the Period Ending December 31, 2000

| New Construction | |
|--|---------------------|
| Statewide Programs (Manufactured Housing) | \$115,625 |
| Residential design Assistance | 1,355,784 |
| Industry & Consumer Info and Promotion | 312,073 |
| CHEERS | 41,951 |
| New Energy Efficient Products and Services | 74,148 |
| CEC Public Interest Energy Research (PIER) | 76,474 |
| Targeted Third Party Initiatives (TPI) | 76,543 |
| Savings by Design | 1,766,492 |
| Energy Design Resources | 396,193 |
| New Construction Total | \$4,215,283 |
| Energy Efficiency Program Total | \$32,005,208 |

Note: The total Energy Efficiency Program expenditures summarized in the financial statements for the years 2000-2002 do not agree with the totals shown in Exhibit V-49 because Summer Initiative Program expenditures were omitted from the Company's initial response to DR JDH-001-02 and are shown separately on the last page of this schedule.

SDG&E Expenditures for the Period Ending December 31, 2001

| Residential Programs | |
|---|---------------------|
| Statewide Energy Guide | \$36,256 |
| Information & Education | 1,428,300 |
| In-Store Energy Efficient Demonstration Co-op Program | 90,770 |
| Schools | 621,067 |
| Energy Information Center | 216,642 |
| Energy Management Services | 770,119 |
| Downstream Appliance Incentives | 1,488,575 |
| Downstream Lighting | 192,555 |
| Multifamily Rebate | 3,113,289 |
| Single Family Rebate | 3,416,251 |
| Statewide Upstream Appliances | 53,350 |
| Targeted Third Party Initiatives | 589,808 |
| Statewide Upstream Lighting | 2,123,283 |
| Residential Total | \$14,140,265 |
| Nonresidential Programs | |
| Small Commercial Info | \$317,876 |
| Large Commercial Info | 122,722 |
| Emerging Technologies | 79,523 |
| Energy Efficiency Financing (Energy Cents) | 10,820 |
| Technical Assistance, Small Comprehensive | 145,562 |
| Building Operator Certificate | 63,457 |
| Technical Assistance, Process | 360,414 |
| Building Efficiency Rating Tool | 68,004 |
| Energy Information Center (EIC) | 83,861 |
| Small Commercial Audits | 555,540 |
| Peak Load Reduction (TPI) | 1,230,502 |
| Tenant Improvements | 856,186 |
| Express Efficiency | 2,397,948 |
| Commercial Horizontal Washers | 289,506 |
| Turnkey Pilot/EZ Turnkey | 647,376 |
| Nonresidential Standard performance Contract (NRSPC) | 5,558,704 |
| Small Business SPC (SBSPC) | 1,445,403 |
| Upstream HVAC Incentives | 264,269 |
| Upstream Motors Incentives | 102,961 |
| Building Recommissioning TPI | 202,532 |
| Retrofit and Leased Space PI | 118,249 |
| Nonresidential Total | \$4,921,415 |

SDG&E Expenditures for the Period Ending December 31, 2001

| New Construction Programs | |
|--|---------------------|
| Industry & Consumer Info and Promotion | \$83,728 |
| CHEERS | 31,865 |
| Home Energy Partnership | 2,386,132 |
| Builder Training | 140,070 |
| Savings by Design | 3,297,683 |
| Energy Design Resources | 344,326 |
| Ind and Ag New Construction | 752,721 |
| New Construction Codes and Standards Support | 250,973 |
| Local Government Initiatives | 257,087 |
| New Construction Total | \$7,644,585 |
| Energy Efficiency Program Total | \$36,706,265 |

Source: SDG&E-JDH-001-Q2

Note: The total Energy Efficiency Program expenditures summarized in the financial statements for the years 2000-2002 do not agree with the totals shown in Exhibit V-46 because Summer Initiative Program expenditures were omitted from the Company's initial response to DR JDH-001-02 and are shown separately on the last page of this schedule.

SDG&E Expenditures for the Period Ending December 31, 2002

| | Q1 & Bridge | Q2-Q4 | Total |
|--|--------------------|--------------------|--------------------|
| Residential Programs | | | |
| Appliance Recycling | \$- | \$993,361 | \$993,361 |
| Single Family Energy Efficiency Rebates | 557,243 | 3,289,334 | 3,846,577 |
| Multi-Family Energy Efficiency Rebates | 491,093 | 1,313,647 | 1,804,740 |
| Statewide Energy Guide | (3,137) | | (3,137) |
| Information & Education | 339,758 | | 339,758 |
| In-Store energy efficiency Demonstration Co-op Program | 5,792 | | 5,792 |
| Schools | 50,380 | | 50,380 |
| Targeted Third Party Initiatives | 45,825 | | 45,825 |
| Energy Information Center | 58,578 | | 58,578 |
| Energy Management Services | 115,448 | 432,246 | 547,694 |
| Downstream Lighting | 60,206 | | 60,206 |
| Statewide Upstream Lighting | 250,084 | | 250,084 |
| HTR Lighting Turn-In | | 496,256 | 496,256 |
| Residential Total | \$1,971,270 | \$6,524,844 | \$8,496,114 |
| Nonresidential Programs | | | |
| Small Commercial Info | \$45,777 | | \$45,777 |
| Large Commercial Info | 22,633 | | 22,633 |
| Technical Assistance, Small Comprehensive | 11,512 | | 11,512 |
| Technical Assistance, Process | 21,718 | | 21,718 |
| Building Efficiency Rating Tool | 207 | | 207 |
| Energy Information Center | 18,822 | | 18,822 |
| Small Business Assessment | 23,008 | 369,458 | 392,466 |
| Peak Load Reduction TPI | 927 | | 927 |
| Tenant Improvements | 160,575 | | 160,575 |
| EZ Turnkey | 651,345 | 858,721 | 1,510,066 |
| Upstream HVAC Incentives | 1,352 | | 1,352 |
| Upstream Motors Incentives | 401 | | 401 |
| Building Recommissioning TPI | 42 | | 42 |
| Retrofit and Leased Space TPI | 437 | | 437 |
| Nonres Standard Performance Contract | 415,824 | 2,536,758 | 2,952,582 |
| Small Business SPC | 228,120 | | 228,120 |
| Express Efficiency | 235,184 | 2,575,724 | 2,810,908 |
| Commercial Horizontal Washers | (255) | | (255) |
| Small Commercial Audit | 67,384 | 633,944 | 701,328 |
| Building Operator Certification | 27,932 | 164,901 | 192,833 |
| Nonresidential Total | \$1,932,945 | \$7,139,506 | \$9,072,451 |

| New Construction Programs | | | |
|--|--------------------|---------------------|---------------------|
| Industry & Consumer Info and Promotion | 5,930 | | 5,930 |
| CHEERS | 163 | | 163 |
| Home Energy Partnership | 156,127 | | 156,127 |
| Savings by Design | 445,411 | 2,998,803 | 3,444,214 |
| Energy Design Resources | 52,499 | | 52,499 |
| Ind and Ag New Construction | 30,922 | | 30,922 |
| Local Government Initiatives | 42,288 | | 42,288 |
| California ENERGYSTAR New Homes | | 2,057,644 | 2,057,644 |
| New Construction Total | \$733,340 | \$5,056,447 | \$5,789,787 |
| Crosscutting Programs | | | |
| Education and Training | \$144,351 | \$1,120,978 | \$,265,329 |
| Codes and Standards Advocacy | 8,192 | 87,822 | 96,014 |
| Emerging Technologies | 53 | 73,131 | 73,184 |
| Lighting Turn-In | | 1,401,998 | 1,401,998 |
| Energy Code Training | 49,131 | 168,443 | 217,574 |
| Crosscutting Total | 201,727 | 2,852,372 | 3,054,099 |
| Energy Efficiency Program Total | \$4,839,282 | \$21,573,169 | \$26,412,451 |

Source: SDG&E-JDH-001-Q2

Note: The total Energy Efficiency Program expenditures summarized in the financial statements for the years 2000-2002 do not agree with the totals shown in **Exhibit V-49** because Summer Initiative Program expenditures were omitted from the Company's initial response to DR JDH-001-02 and are shown separately on the last page of this schedule.

SDG&E Expenditures for Summer Initiative Program 2000-2002

| | |
|---|---------------------|
| Non-Utility Programs | |
| Beat The Heat--ECOS Consulting | \$157,538 |
| Residential Refrigerator Recycling --ARCA | 3,022,215 |
| Pool Efficiency Program | 1,667,656 |
| UC - UC San Diego | 1,017,986 |
| CSU - San Marcos | 881,244 |
| Residential Hard To Reach | 1,436,881 |
| LED Traffic Signal Rebate Program | 3,369,614 |
| Subtotal | \$11,553,133 |
| Utility-Specific Programs | |
| Whole House Fans | \$104,466 |
| Halogen Torchieri Turn-In | 49,711 |
| Third Party Initiatives | 707,906 |
| Subtotal | \$862,082 |
| Total | \$12,415,216 |

Source: SDG&E JDH-001-Q2.

G. SCG

1. Background

SCG's total expenditures for energy efficiency programs during the 1998-2002 audit period were approximately \$138 million, divided into the program categories detailed in **Exhibit V-57**.

**Exhibit V-57: SCG's 1998-2002 Energy Efficiency Expenditures
Were Approximately \$138 Million
(Dollars In Thousands)**

| Program Category | General Program Description | Expenditure Amount |
|------------------------------------|---|--------------------|
| Residential | Incentives to residential customers to encourage investment in energy efficient products. The incentives were in the form of direct customer rebates, vouchers presented to contractors for a reduced fee, point-of-purchase rebates, and other direct and indirect program participation incentives. | \$31,443 |
| Nonresidential | Programs targeting commercial, industrial, and agricultural businesses providing rebates for efficiency gains or inefficiencies avoided. | 57,441 |
| New Construction | Incentives to builders to construct homes at least 15 percent more energy efficient than current California code standards. | 22,533 |
| MA&E & Regulatory Oversight | Measurement, Assessment and Evaluation: This budget item relates only to the cost of assuring compliance with Commission energy savings goals, as well as conducting Commission required studies. | 8,035 |
| Shareholder Performance Incentives | This budget item is not specifically a program, but it is for funds available to SCG for meeting targets in a timely manner. | 5,135 |
| Cross-cutting | Programs with impacts that cut across several program categories, including information and marketing outreach efforts. | 5,452 |
| Summer Initiatives | Statewide and specific programs aimed at reducing energy consumption during the summer period. | 7,927 |
| Total | | \$137,966 |

Source: Compiled from SCG's annual reports to the Commission.

Accounting Systems

SCG uses several accounting and project management systems to support its energy efficiency program activities: Energy Efficiency Tracking System (EETS), SAP, and Workforce Information and Timekeeping System (WITS).

- SAP was implemented at SCG in June 1999 and is SCG's financial accounting system. As it relates to the energy efficiency program, SAP is the primary accounts payable and payment processing system. Transactions are coded using Internal Order numbers pertaining to specific energy efficiency programs in specific years, and by detailed cost element showing the nature of a particular entry.

Prior to the implementation of SAP, SCG used Budget and Accounting System (BAS) as its financial accounting system.

- EETS is an on-line database system that tracks the details of each rebate and incentive program. Once applications have been confirmed to be complete and appropriate, applications are manually entered into the EETS system by data entry personnel. For some programs, rebate amounts have been pre-loaded into EETS and are selected from drop-down menus. EETS interfaces with SAP, SCG's financial accounting system, for payment processing. EETS was designed to meet the specific reporting needs of the Commission and reflects reserved incentive rebates (commitments), installed rebate activity waiting for payment, and paid rebates.
- WITS tracks labor deployment. Includes a classification of cost area to which labor charges are recorded based on predetermined coding or alternative coding on the timesheet. Managers may and do adjust the cost coding from time to time as appropriate. Costs from WITS are loaded directly into SAP.

SCG classifies its energy efficiency costs in three categories: labor, incentives and "other." Costs are assigned an internal order (IO) number that relates the cost to a specific program and program year. IOs are 12 alphanumeric characters long and are hand-transcribed or hand-keyed into documents, such as time and expense reports and cost allocation forms. In theory, IOs correspond to programs and to years. A subset of IOs, called elements, provide specific cost categorization. Some program years utilized more than one IO. SCG did not change IOs on an annual basis prior to 2002.

2. Summary of Adjustments

A summary of balancing account adjustments identified in this audit is shown below.

**Exhibit V-58: Balancing Account Adjustments Were Identified
(Dollars in Thousands)**

| Item | Amount | Reason for Adjustment |
|--|--------------|---|
| A Portion of Costs Need to Be Adjusted | | |
| Costs reported in PY 2000 that related to PY 1997 and 1998 | 195 | Costs that were accumulated from October 1997 through September 1998 were charged as part of PY 2000. |
| SCG Website Design | \$166 | Cost represents a partial payment for a complete redesign of SCG website. |
| Total | \$361 | |

blueCONSULTING also questions SCG's CEA interest calculation methodology. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7.4) million, a difference of (\$8.0) million.

3. Conclusions

C34. blueCONSULTING's ability to audit SCG's energy efficiency costs was hindered because transaction level information prior to July 1999 was not readily available through SAP, and we were provided with little of the requested documentation for other years.

- Prior to July 1999, cost data were captured at a detailed level in BAS; however, at the time of the conversion to SAP in July 1999, data were transferred from BAS to SAP at a summary level. Electronic detailed transaction level data from January 1998 through June 1999 were not readily available. Accounting data subsequently recorded in SAP were at a detailed level.
- We received approximately 50 percent of all requested audit evidence for the 505 items classified as "other" costs within our sample. While some evidence was provided for most transactions, only half of the normally-retained information we requested was provided. All costs within SAP that served as the basis for sampling were classified into one of only three categories: incentives, labor and "other." Therefore, the "other" category contained a large variety of costs, such as travel and entertainment, vendor and subcontractor costs, consulting costs, material procurement and all non-labor allocated costs.
- The total amount of tested transactions was approximately \$14.6 million. However, little documentation was available for auditing purposes.
 - ⇒ Proof of an acceptable bidding process was not provided for 11 percent of the tested transactions.
 - ⇒ There was no evidence of the delivery or installation of goods, or a contract or agreement outlining the provision of services and a related invoice, for six percent (or \$149,000) of the tested transactions.
 - ⇒ There was no evidence of an obligation for payment (e.g., no invoice or other bill for services or goods) for seven percent (or \$186,000) of the tested transactions.
 - ⇒ Proof of an approved individual authorized payment was lacking for another seven percent (or \$1.7 million) of the tested transactions.
 - ⇒ Two percent of the tested transactions were not reported in the correct period.

C35. SCG does not have an accurate methodology for cost allocation or direct assignment of costs. The volume of costs allocated, coupled with a lack of an acceptable allocation methodology, compromised the reliability of SCG's reported results

- SCG does not have official policies and procedures for the methodology for administrative cost allocation. SCG does not accumulate indirect costs charged to energy efficiency programs and allocate based on a cost allocation study. There is a lack of activity-based analysis supporting cost allocation.

- Labor and other administrative costs are allocated to individual programs based upon the budget assigned to each program by the Commission.
- Numerous large dollar cost items recorded in SAP are transfers, corrections or allocations based on human estimation and are not recorded directly from specific transactions.

C36. SCG's expenditure accrual process is problematic, and some significant expenditures had insufficient documentation. The informality surrounding the tracking of expenses, and in particular the reclassification of expenses, diminishes the accuracy of expense accumulation and tracking.

- Current procedures rely heavily on estimates made with little, if any, supporting analyses or calculations.
- During the 1998-2002 timeframe, SCG accrued expenses based on "commitments." As the actual costs were incurred, the accrued expenditures were credited. For accrued expenditures not realized, SCG would reverse the accrual and re-accrue the cost into the current period, repeating this process until the actual expenditure was made. This represented approximately one-third of the total transactions in some years and is an opportunity for errors because there is a significant amount of human activity in the transaction process. The IO numbers used to classify costs are long, which may lead to an employee incorrectly entering a number. In addition, managers frequently reclassify charges, and some of these reclassifications may be due to FERC accounting.
- Other instances of reclassification occur when a manager decides that a costs charged to one category should have been charged to a different category. These reclassifications can be accomplished with no further analysis or supporting documentation. This assumes a high level of integrity amongst all involved in the discussion and reclassification of expenses.

C37. Program funding and commitments were tracked using spreadsheets and databases, allowing such costs to escape the basic controls of a double-entry accounting system. Program expenditures are tracked in SAP (or BAS), but they are readily adjustable by a number of individuals. This lax accounting environment allows human error to go undetected and unchecked in numerous accounting processes for the program area.

C38. Several transactions tested were unsupported, had questionable costs or represented costs not related to energy efficiency programs.

- Individual transactions are recorded in the accounting system and are recorded by program and expenditure type using a chart of accounts. Transactions are entered into the system of accounts and are backed up by invoice or other appropriate documentation.
- Appropriate program management personnel submit program-related expenditures for approval before being processed.

- A transaction dated April 8, 1999, and posted January 31, 2000, in the amount of \$195,422, which has been identified to PY 2000, was actually for services that were performed between October 1997 and September 1998 and should have been reported in that time frame. This transaction appeared in the audit sample from SAP for 1998-2002, though SCG contends the amount was not reported as a program expense for the audit period, because it was known to relate to earlier program years. SCG contends the transaction was outside the scope of the audit. The fact that the transaction appeared in SAP highlights a weakness in the link between cost accumulation and cost reporting.
- A transaction dated January 31, 2000, and posted March 29, 2000, in the amount of \$166,000, which has been identified to PY 2000, was a partial payment of a redesign of the Commercial and Industrial portion of SCG's website. Only a portion of the redesign is attributable to energy efficiency programs and therefore should only bear the costs for that portion. SCG estimates that the non-energy efficiency component represents approximately 20 percent of the total charges.
- A transaction dated December 9, 1999, and posted December 9, 1999, in the amount of \$65,500, has been identified as PY 1999. This cost was recorded as employee benefit expense, which, according to SCG representatives, is not charged to energy efficiency programs. After investigating this transaction, it was determined the actual cost was for services provided by a vendor.
- A transaction dated November 30, 2000, and posted November 30, 2000, in the amount of \$12,000, has been identified to PY 2000. The transaction was recorded as labor costs but should have been classified as non-labor costs. In addition, no evidence supporting the validity of the transaction was provided. SCG contends the expenditure was energy efficiency-related.
- Two transactions dated December 10, 2001, and posted December 10, 2001, in the amounts of \$70,000 and \$39,597, have been identified to PY 2001. These transactions record the amounts allocated from the director of Mass Markets and support staff to energy efficiency programs. No supporting documentation was provided to identify the amounts to be allocated, the method of allocation, or the rationale for allocation. SCG contends the reclassification was done for FERC accounting purposes only. SCG's IOs are related to FERC accounts (i.e., the first three digits reflect the FERC category). As part of the Cost of Service preparation process, it was determined that the Mass Markets director and the director's support staff's energy efficiency labor was more appropriately categorized as FERC 907 versus FERC 910. SCG contends this transfer was done to comport with FERC activities.
- Some significant expenditures (between \$1,000 and \$10,000) originate with employee expense reporting. Such expenditures were not supported by:
 - ⇒ the names or company affiliations of persons attending events
 - ⇒ a statement of business purpose for the event

⇒ a detailed invoice delineating the purpose of the expenditure.

C39. Labor costs for energy efficiency programs are allocated to individual cost elements based on the funding budget created by the Commission and do not reflect the actual activity underlying such costs.

C40. SCG's method for calculating interest charges and credits to the Conservation Expense Account (CEA) differs from the method used by SGD&E, and from the method used by SCG for other balancing accounts. Through August 2003, SCG recorded \$608,509 of interest in the CEA. Under a more traditional method, SCG would have recorded (\$7,385,565), a difference of (\$7,995,074).

- As described in its Preliminary Statement effective December 1, 1990, “[i]nterest will be calculated on a period-to-date basis in the manner described in Preliminary Statement, Part F. However, the interest rate will be divided by 12 and multiplied by the number of months in the period. The period to date is the time between the last general rate cycle and the end of the current month.” Part F states: “Interest will accrue monthly to the Balancing and Memorandum Accounts set forth in Preliminary Statement, Part E. The calculation will be based on the average of the beginning and ending balance of such accounts at the rate of 1/12 of the most recent month’s interest rate on Commercial Paper...”
- SCG does not accrue interest monthly on its energy efficiency balancing accounts. Rather, it recalculates and records interest for a program period (from January 1, 1997 to the current month) while simultaneously removing interest recorded for all previous months during the period. SDG&E uses a different, more standard methodology whereby interest is recorded monthly and is calculated by applying the interest rate to the average of the beginning balance and ending balance for the period, where the period is defined as the current month. SCG defines the period as from the last rate case (January 1997) through the current month.
- SCG’s methodology appears to be inconsistent with Generally Accepted Accounting Principles (GAAP), and serves to understate the balance relative to a more traditional method of interest calculation. Since revenues exceeded expenses in the CEA account for the first three years that the account was used (1997, 1998, 1999), SCG’s method of calculating interest continues to result in interest on unexpended historical balances in current periods. There is no GAAP exception to the requirement for contemporaneous recognition of expenses, and GAAP includes a provision regarding the matching principle of accounting.
- As of August 2003, SCG reported interest due from the account in the amount of \$608,509. blueCONSULTING restated this amount to be \$7.4 million, using more traditional methods of interest calculation. SCG’s under-estimation of average account balance and its accrual of interest on a period to date rather than monthly basis result in an understatement of interest due to the CEA, as shown in **Exhibit V-59**.

**Exhibit V-59: SCG's Method of Calculation of Interest Charges and Credits to the CEA Results
in an Approximate \$7.4 Million Difference Over More Traditional Methods Through August
2003
(Dollars in Thousands)**

| Interest Item | Amount |
|---------------------------------|------------------|
| SCG recorded interest | \$609 |
| blueCONSULTING revised interest | (\$7,387) |
| Difference | (\$7,995) |

| Details of SCG's Interest Calculation | | | |
|--|--------------|-------------------------------|--|
| Sum of Interest Rates | 346.00% | | |
| # of Periods | 80 | | |
| Divide by # of Periods | 4.33% | Average Rate | |
| Divide by 12 | 0.360417% | Monthly Rate | |
| Beginning Balance w/out Interest | - | | |
| Ending Balance w/out Interest | 8,853 | | |
| | \$4,426 | Average Balance | |
| Monthly Rate | 0.36% | | |
| Average Balance x Monthly Interest Rate | \$16 | Monthly Interest | |
| # of Periods | 80 | | |
| Monthly Interest x # of Periods | \$1,276 | Total Cumulative Interest | |
| Less: Prior Interest | 668 | | |
| | \$609 | Current Month Interest | |

| Details of Difference | |
|---|----------------|
| Effect of understated average balances | \$4,632 |
| Effect of not accruing interest monthly | \$3,363 |
| Aggregate Difference | \$7,995 |

Source: blueCONSULTING Analysis.

- According to SCG: "This period-to-date interest calculation currently being used by [SCG] has been reviewed and approved by the Commission for example in the 1990-1993 and 1994-1996 program cycles in which the balances have subsequently been reviewed and approved by the Commission for amortization in rates in Years 1997 through 2000. There have been no modifications to the period-to-date calculation proposed by the Commission."

4. Recommendations for the Company:

R18. SCG should make adjustments as specified in the Summary of Adjustments section.

R19. SCG's allocation of labor cost to energy efficiency programs should be recorded based on the actual effort expended on the various cost elements. This would provide accurate information as to the true costs of individual programs and assure that costs are properly reported to the Commission. (Refers to Conclusion No. C35)

- R20. SCG should develop policies and procedures that will improve the company’s ability to properly classify costs to the program year to which they apply. This would properly classify the cost and would assist in the development of accurate records and assure costs are properly reported to the Commission. (Refers to Conclusion No. C36)**
- R21. SCG should develop policies and procedures to charge only the portion of costs that are related to energy efficiency programs to those programs. This would assure that energy efficiency programs would only be charged their fair share. (Refers to Conclusion No. C37)**
- R22. SCG should overhaul its employee expense reporting policies to bring reporting standards at least to that required by the Internal Revenue Code. That would require that expenditures be backed by a statement of business purpose and a list of persons in attendance with company affiliations and/or titles. Currently, there is no requirement that the business purpose of many expenses be documented, thus leaving it unclear if the expense is actually energy efficiency related. Also, a record of the expenditure detail should be kept such that it can be known what was purchased with a credit card charge. (Refers to Conclusion No. C38)**
- R23. SCG should raise the threshold of accountability for reclassifying costs from one internal order (which roughly corresponds to a program) to another. Currently, reclassifications are numerous, large, and not supported by analysis or rationale. The volume of reclassifications threatens the accuracy of the cost data accumulated to specific programs and to specific cost codes. Reclassifications should be made only on the basis of a reasoned statement of the need to reclassify and a written estimate of the amounts, supported by a written calculation. Shifting expenses to match expenses to program budgets should be prohibited, as this is tantamount to fund shifting outside the fund shifting guidelines (Refers to Conclusions No. C35, C36)**
- SCG should require that indirect costs charged to programs be based on a rational and reasonable apportionment methodology based on good faith estimates of the distribution of benefits arising from the services procured to specific programs. SCG should use the same quality controls on the allocation of program costs as it does on other costs of operations outside the EE programs area.
 - Adjustments to or reclassifications of expenses between programs or between periods should be done only on the basis of a detailed calculation of the amount of the adjustment, a documented rationale for the adjustment or reclassification, and over the signature and date of a requestor as well as the approval of a program manager or senior programs executive.

5. Policy Issues for the Commission:

- R24. The Commission should review SCG's interest calculation, clarify its position with respect to interest calculation methodologies, and require adjustments as necessary to the CEA account and any other balancing account where a similar calculation methodology was employed. (Refers to Conclusion No. C40)**
- R25. The Commission should adopt a standard that any non-GAAP or unusual financial measurement techniques be explicitly stated by the IOU in each report to the Commission where such non-GAAP accounting is incorporated. (Refers to Conclusion No. C40)**